98th Congress
*1st Session*

SENATE

Report No.
98-9

# LEGISLATIVE AND OVERSIGHT ACTIVITIES DURING THE 97TH CONGRESS BY THE COMMITTEE ON SMALL BUSINESS

## REPORT

OF THE

## COMMITTEE ON SMALL BUSINESS
## UNITED STATES SENATE

February 23, 1983.—Ordered to be printed with illustrations

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FEBRUARY 23, 1982.—Ordered to be printed

Mr. WEICKER, from the Committee on Small Business
submitted the following

# REPORT

## INTRODUCTION

### THE SMALL BUSINESS COMMITTEE

The past two years have been active and exciting ones for the Small Business Committee. The small business community, long overlooked and ignored in Federal policy-making despite its importance to our national economy and our country as a whole, began to coalesce and assert itself as a force for change in the formulation of national economic and regulatory policies. And this Committee, which had been only a "Select" committee with limited powers and influence, saw its status elevated as well.

The 97th Congress was also the session that saw three major pieces of small business legislation passed and signed into law. Enactment of the Act, the Small Business Innovation Development Act and an amendment to the Small Business Patent Procedures Act, represented substantial victories for this Committee and the small business community.

But if these past two years have brought positive changes for small businesses, they have also been times of enormous trial and challenge. Interest rates, unemployment and business failures went steadily up, as the rate of production, ordering and consumer buying went down. Small businesses, which have traditionally been the cornerstone of our free enterprise system, bore the brunt of the dismal economic times, with many going under and others barely surviving.

This Committee has been and will continue to be actively involved in trying to find solutions to the economic woes of the nation's small businesses. A national economic recovery is dependent,

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in our view, on a recovery by the small businesses that form the foundation of our economic structure.

During the 97th Congress, the Small Business Committee took a two-pronged approach to improving and strengthening the lot of small businesses in this country. The first part of that effort involved the Small Business Administration, over which the Committee has legislative authority.

Rather than simply allocating funds or designing new programs for the SBA to administer, the Committee dedicated itself to making sure that the agency was truly serving its constituency of small business men and women across the country, whether through financial or management assistance, or simply by acting as an advocate for the needs of small business within the Federal decision-making process.

In that regard, the Committee embarked on a strong course of oversight of the SBA and its programs to make sure that those programs already in place were fulfilling their Congressional mandate and serving those people they were designed to serve.

In six comprehensive hearings over the past two years, this Committee let it be known that it will demand accountability, that its Members will search out waste and fraud where they exist, and that it will work to ensure that the SBA is giving its vital small business constituency the kind of effective, efficient representation that its deserves.

Under its charter, the Small Business Committee also has a mandate to review and investigate the problems facing small business and to suggest remedial action when appropriate. It is in that area that the Committee's important role as an advocate comes into play.

When national economic, tax, procurement, or regulatory policies are debated, this Committee has made every effort to bring the views of small business into the deliberations.

## CHAPTER ONE: SMALL BUSINESS AND THE ECONOMY

### A. THE STATE OF SMALL BUSINESS

It is clear that small businesses in this country are currently in a time of crisis and challenge. The economic storm of inflation, high interest rates, dwindling capital and rising energy and equipment costs has claimed a record number of victims, many of them small firms. But with crisis often comes change, and eventually, growth. While many businesses have gone under, others have hung on and survived, and in the process, they have become stronger.

As part of this Committee's continuing effort to focus the attention of Congress and the Executive Branch on the problems and needs of small businesses, the Committee, during the 96th Congress, proposed—and the Congress passed—legislation requiring the President to report annually on the state of small business and competition in the United States. The first annual report on the State of Small Business was issued by President Reagan in March, 1982.

The following statistics, taken from the report, illustrate the role of small business in our national economy.

There are 10,000 large companies in the U.S. with 500 or more employees which do business at 415,000 separate business establishments. The remaining 99.8 percent of the 15 million businesses in the country may be called small.

The small businesses employ 47 percent of the non-government labor force whereas the 10,000 large businesses employ 53 percent of the non-government labor force.

The small businesses produce 38 percent of the nation's Gross National Product whereas the 10,000 large businesses produce 62 percent of the nation's Gross National Product.

In 1977 (the latest date available), 14.7 million businesses filed tax returns with the Internal Revenue Service. Of that 14.7 million, 11.3 million or 76.9 percent, were proprietorships, and 2.2 million, or 8.2 percent, were partnerships.

Those industries traditionally controlled by smaller businesses are agriculture, forestry and fishing, contract construction, wholesale trade, retail trade and services. In the nontraditional small business industries (manufacturing, mining, finance), small firms account for 10 to 20 percent of industry sales and 20 to 30 percent of industry employment.

Less than 9 percent of the nation's 300,000 manufacturers export regularly and less than 1 percent account for 84 percent of U.S. exports. Small businesses, while representing 38 percent of the Gross National Product, produce only 16 percent of export sales.

On March 31, 1982, the President's report was presented to the Committee by Frank Swain, Chief Counsel for Advocacy at the Small Business Administration, and Murray Weidenbaum, then Chairman of the President's Council of Economic Advisors.

At that hearing, Mr. Weidenbaum testified that while he continued to be disturbed about the size of the Federal deficit, the rate of inflation and steadily climbing interest rates, he was confident that the economic policies enacted by the Administration would bring about a recovery for business in general, and small business in particular. "Although all segments of the economy are going through very difficult times . . . this Administration is attempting to put into place a program which will create a positive, long term environment in which small businesses can be formed and grow and prosper," Weidenbaum said.

The President's report is the first comprehensive policy statement on small business by the Administration, and the Committee believes it will be an important annual resource in the years to come.

The President's introductory message and overview of the report may be found in Appendix E of this document.

### B. CAPITAL FORMATION

One of the major priorities of the Small Business Committee in this Congress has been to help bring about a change in our nation's tax laws in order to create tax equity for small business, and to promote capital investment, productivity and enhanced private sector job creation.

Committee Members believe it is important that Federal policymakers realize that while small businesses play a unique role in the national economy, they also have unique needs and circumstances. In most cases, what works for big business in terms of tax remedies and financing strategies simply cannot be applied with equal success to a small firm.

That is why, at the start of the 97th Congress, Senators Weicker and Nunn introduced S. 360, a comprehensive tax package aimed at directly improving existing tax laws to enable small businesses to attract and retain capital. The Small Business Capital Formation Act of 1981, cosponsored by Committee Members Baucus, Packwood, Hatch, Hayakawa, Huddleston, Sasser, Boschwitz, Tsongas, and a number of other Senators, sought to address difficulities small firms were having in attracting long-term capital for new investments in plants and equipment, and in retaining capital generated internally.

S. 360 took a two-pronged approach to these problems by proposing 1) significant new tax credits, rollovers, and other incentives to encourage investors to make long-term equity capital available to small businesses; and 2) important new tax provisions to permit greater earnings retention. The bill called for reductions in corporate tax rates, accelerated and simplified depreciation deductions, reductions in inventory accounting burdens, and reforms in estate and gift tax laws.

This bill became the point of departure for Senate consideration of small business tax legislation during the first session of the 97th Congress, as numerous other bills were subsequently introduced in the Senate or the House.

On March 9, 1981, the Committee held a hearing on the "Role of Small Business in the Nation's Economic Recovery" to receive small business reaction to the proposals in S. 360, and to hear the views of economists, small business owners and associaiton representatives, on their tax priorities for the 97th Congress. As a result of that hearing, Senators Weicker and Nunn testified before the Finance Committee on May 27, 1981, and recommended the following provisions of S. 360 as priorities for enactment.

1. Further reduction and graduation of corporate income tax rates and an increase in the surtax exemption.
2. Capital gains "rollover"—permitting an individual to sell an interest in a small business and defer any tax consequences so long as the proceeds are reinvested in another small business within a certain period of time.
3. Estate and gift tax reforms—changes to relieve the heavy burden of estate taxes upon the continuity of small business, especially the estate tax exemption and the marital deduction.
4. Small business participating debenture (SBPD)—a new financial instrument to enable small businesses to have greater access to sources of external capital. Firms would be permitted to deduct from taxable income an agreed-upon earnings distribution and investors would treat this distribution as capital gains rather than ordinary income.
5. Investment tax credits for used equipment—to be increased from up-to $100,000 worth of used equipment invest-

ment, to no-less-than $250,000, with a provision for tiered increases up to $500,000 in 1985.

6. Cash accounting for small business—to resolve the difference between cost of goods sold and actual replacement costs of those goods.

Senator Weicker, in his statement to the Finance Committee, estimated the cost of the measures at $3 billion for FY 1982, and asked that the S. 360 package be adopted in the interests of "true supply-side economics."

> Small business is really the essence of supply-side economics, in terms of job creation, innovation and their percentage of the Gross National Product. Our country needs and deserves the contribution that small business is prepared to make toward capital investment and new job creation.

Senator Weicker said. Senator Nunn concurred, and added:

> Small Business needs to be provided with a larger share of the tax cut than the Administration proposes so that needed investment in plant and equipment can get underway in earnest. Small businesses which provide over 80 percent of the new jobs in the economy need to have specific capital formation and retention tax provisions targeted to its needs so that the small business community can fully participate in the economic recovery.
>
> Second, I firmly believe additional incentives for middle income taxpayers to increase savings must be put in place in conjunction with any multi-year tax cut. Such incentives will help provide the guarantee that reduced taxes in future years will result in increased savings.
>
> I support a multi-year tax cut, but I also believe tax decreases in future years should be contingent upon further reductions in federal spending. Such a move would help insure fiscal discipline and a continued reliance on the private sector for economic growth.
>
> Finally, I believe we need to reduce the federal deficit and federal borrowing more rapidly than the President has projected, even if it means reducing the size of the tax cut or spreading it over more years.

When the Economic Recovery Tax Act reached the Senate floor, it contained a number of provisions adapted directly from S. 360, including accelerated depreciation and estate and gift tax reforms. Senators Weicker and Nunn subsequently offered an amendment to the tax bill to make a reduction in the corporate tax rates paid by small business. That amendment, with modifications, passed by a vote of 92–0.

While the 1981 tax law does contain several provisions to encourage greater capital investment in small business, there still exists a substantial unfinished S. 360 agenda, particularly with respect to the attraction of long-term capital. In this climate of unacceptably high interest rates, the Committee believes special measures are required to increase the flow of capital to small business.

That belief is shared by the rest of the small business community, as became evident at a joint hearing held by the House Small Business Subcommittee on Tax, Access to Equity Capital, and Business Opportunities and the Senate Small Business Committee on December 1, 1982. That hearing, chaired by Senator D'Amato and Congressman Nowak, was convened to examine a number of possible remedies to small business capital formation problems. The recommendations were developed from a congressionally-mandated Government-Business Forum on Small Business, held in Washington on September 23–25, 1982. The forum was hosted by the Securities and Exchange Commission.

Approximately 200 persons from throughout the Nation, including small business owner/operators, accountants, attorneys, venture capitalists, bankers, broker-dealers, academicians and government officials, participated in the forum, which was designed to develop proposals to enhance the ability of small business to obtain capital.

As a result of this first annual conference, a report containing 37 recommendations for capital formation was issued. Many of these proposals mirror legislation already developed by the Committee, and in fact, several of the ideas being proposed were put forth as part of the original S. 360 package.

The Committee welcomes these recommendations and the reaffirmation of the concepts embodied in S. 360, and intends to use this valuable forum document as an aid in putting together its capital formation agenda for 1983.

The recommendations of the SEC Government-Business Forum can be found in Appendix F of this document.

### C. INTEREST RATES

Just as inequitable tax policies have impinged upon the small business owners' ability to continue to do business, so too have high interest rates. Nowhere has the impact of high interest rates been more severely felt than in the case of the small business entrepreneur, whose day-to-day cash flow can often determine his failure or success.

The Committee held five days of hearings in 1981 in cities around the country on the issue of high interest rates and their impact on the small business community. The Committee's aim in scheduling this widespread series of hearings was to receive testimony from all regions and segments of the economy—from Main Street to Wall Street.

The Committee believes that these hearings served a valuable purpose by helping to dramatize the severity of the crisis that many small business owners were facing.

The first hearing took place over two days in Washington, D.C. on September 23 and 24, 1981. Witnesses included representatives of labor, the President's Council of Economic Advisors, the Federal Reserve Board and automobile and homebuilders associations.

Jerry Jordan of the Council of Economic Advisors, while deploring the current effects of high interest rates, said the long-term outlook for the President's economic program was good. Jordan called inflation the real "longstanding and chronic" problem hurting small and medium-sized businesses, and said that high interest rates were only "temporary."

Jordan told the Committee:

> While high interest rates capture the headlines, inflation remains the continuing danger. Our program is aimed at this longer-term problem. We should not focus only on the transitory pain of high interest rates in judging the President's program and its effects on small business.

Frederick H. Schultz, Vice-Chairman of the Federal Reserve Board, called this a "critical" time in the history of the country, and warned that upcoming months were "not going to be easy."

> Because of the problems inflation has brought to the economy, it is important that the Government implement policies that focus on bringing the inflation rate down—and keeping it down. For its part, the Federal Reserve has been seeking a gradual moderation over the longer run in the growth of the money supply. As this policy bears fruit, we are confident that the result will be reduced pressures in the credit markets and an eventual decline in interest rates.

Schultz continued:

> We realize that the adjustments required will be painful; we should not expect the reversal of a 15-year trend of accelerating inflation to be accomplished quickly and without unpleasant side effects . . .

Schultz characterized monetary policy for Committee Members as "a blunt instrument" which "is hurting homebuilding, automobile dealers, small businesses, farmers, the thrift industry and municipalities."

Dr. Alan Greenspan, president of Townsend-Greenspan & Co. of New York, while generally supporting the President's economic program, offered some words of caution to the Administration spokesmen, however.

Greenspan said:

> The inflation premium will not disappear as a consequence of eloquent utterances of optimism by the Administration or by pledges of lowered money supply by the Federal Reserve. The markets are skeptical and deservedly so, and will react, in my judgement, only to hard evidence that Federal expenditure and credit growth will slow from the path which it has currently been on. Promises are worth little to the markets.

Following testimony from those witnesses, the Committee heard from some of those small business owners being directly affected by high interest rates.

Clem Watson, a homebuilder from Norwich, Connecticut, said that although he had operated a successful homebuilding business for 25 years, interest rates had increased to a point where he predicted he would be out of business in six months.

Watson said:

> People I built houses for in 1964 and 1965 today send their children to me to build them a house. I have to tell them: I'm sorry; I cannot do anything for you. We are talking about flesh and blood. We are talking about people.

Robert McElwaine, president of the American International Automobile Dealers Association, called high interest rates "a pair of concrete overshoes on this economy. It (the economy) will never take off under these high rates."

Ned Harmon, president of Georgia Young Farmers and a farmer from Carrollton, Georgia, told the Committee that "the high interest rates of our yearly production loans are making it impossible to survive."

Said Harmon:

> Farmers are the most patriotic and most willing to sacrifice people in the Nation. However, I ask you: What can we do now? We have given all that we have to give.

At the Committee's October 13, 1981 hearing in Hartford, Connecticut, State Senator Carl Zinsser said that "high interest rates have become the No. 1 domestic problem." Richard Curcio, a building supplier and homebuilder said:

> My biggest problem today is [that] my biggest competitor is you, the Federal Government. I can't compete with you. I can't go into the credit market and get 18-20 percent loans—last year, 22 percent loans—to carry my inventory.

Elizabeth C. Pattee, President of the Connecticut Association of Realtors and a realtor from Hartford: "Interest rates are taking us right out of the American dream."

On Wall Street, New York City, on October 14, 1981, Jay Harbeck, Senior Vice President of the U.S. Trust Company, said that interest rates could not be expected to come down immediately, and counseled "patience and restraint" on the part of the Federal Government and the public.

Harbeck advised:

> It is up to Congress to maintain a consistent course in controlling and reducing inflation. If Congress is consistent, interest rates will retreat—slowly, to be sure—but steadily.

On October 19, Senator James Sasser held a field hearing on the interest rate problem in Memphis, Tennessee. At that hearing, Terry Britt, Vice-President of Sparks Commodities of Memphis, testified:

> Where do we go from here? The time for political games is over. New priorities are needed. Balance the budget is No. 1. No. 2, place all off-budget financing within the U.S. budget. No. 3, reality requires that we admit that we cannot achieve every social and economic plan, or perceived need at once. Lower the defense budget—$10 billion, $5 billion, whatever billion you wish, but lower the defense budget in 1982—defer some of those projects or stretch them in 1983 or 1984.

> The Nation and the people, No. 4, need to get back to the basics such as pay as you go, hard work is honorable, thrift is good. No. 5, the basic requirement is the realization that all social and economic programs entail a cost which must be paid for in one form or another. There is no such thing as a free lunch. If this realization becomes prevalent and if the costs become clear, there will be no need for the Federal Reserve to monetize huge Government deficits, because the deficits will fall.

The Committee will continue to examine the question of high interest rates in the upcoming Congress, and seek solutions to this problem, which has unfortunately become the most serious dilemma facing the small business owners of this Nation.

### D. SAFE HARBOR LEASING

On March 2, 1982, the Committee on Small Business held hearings which examined the usability by small business of the safe harbor leasing provisions enacted in the 1981 Economic Recovery Tax Act.

During the course of the hearings, the overriding complaint voiced by the Members of the Committee, as well as by the witnesses, related to the U.S. Treasury Department's application of the so-called "at-risk" rules to closely-held corporations entering into safe-harbor leasing transactions. The concept of "at-risk" was introduced in the Tax Reform Act of 1976, and it was intended to limit tax shelters by altering the timing of deductions, so that a taxpayer could not claim deductions in excess of the amount of cash and recourse debt that he had invested in an activity at the end of any year.

By requiring that these at-risk rules, found in Section 465 of the tax code, apply to closely-held lessors, many closely-held companies were excluded from economically engaging in safe-harbor leasing transactions because the timing for both ACRS deductions and the investment tax credit that would be generated by the lease, was severely restricted. As Senator Weicker indicated in his statement, "the at-risk rules that small companies are subject to destroy the economics of the transactions."

Moreover, as Senator Nunn pointed out in his statement before the Committee, "discrimination results because the at-risk rules impose no restrictions at all on publicly-held companies." The at-risk rules applied only to individuals, Subchapter S firms and closely-held companies, and not to publicly-held firms. As a consequence, the manner in which the Treasury Department was applying the at-risk rules was unfairly preventing small business from benefiting from safe harbor leasing. In fact, during the hearing, the Treasury Department, represented by John E. Chapoton, Assistant Secretary for Tax Policy, recognized this inequity and indicated that they would not oppose carefully drafted legislation that removed application of the at-risk rules to closely-held lessors. The latter measure was unanimously supported by the small business community representatives that testified during the hearing.

In keeping with these recommendations, during the debate of the Tax Equity and Fiscal Responsibility Act of 1982 (H.R. 4961), Senators Nunn and Dixon successfully offered an amendment which repealed the application of the at-risk rules to closely-held corporations seeking to enter into a safe harbor leasing transaction as lessors. Under the terms of the amendment, now enacted into law as part of that tax act, small, closely-held businesses will be able to take advantage of the benefits derived from safe harbor leasing transactions in the same manner as other lessors.

## CHAPTER TWO: THE SMALL BUSINESS ADMINISTRATION

The principle jurisdiction of the Senate Small Business Committee is to exercise legislative and oversight responsibility over the programs administered by the Small Business Administration. At the start of the 97th Congress, however, the Chairman annonced that he intended to extensively scrutinize those programs to make sure that the Small Business Administration, as a whole, was truly serving its constitutuency of small business men and women across the country.

If the past two years have been times of trial and transition for many small businesses, they have also been times of change for the Small Business Administration. Often criticized and much maligned over the years, the Agency has worked hard with the Committee in this Congress to improve its image and its service to its constituency.

Where legislative corrections needed to be made, the Committee has made them. Where administrative improvements in policy and procedure were necessary, the Committee has taken steps to see that changes are made. Through the reconciliation process, legislative and budgetary reforms have been enacted to re-establish the priorities of the SBA, and to shift the emphasis of the Agency to what the Committee believes are more productive, more cost-effective areas. Through the oversight process, which will continue in the 98th Congress, programs and policies that are in place are being scrutinized to make sure that the intent of Congress and the needs of the small business community are being fulfilled.

The result, in the Committee's view, has been a stronger, more effective Small Business Administration. The Small Business Administration is the only agency in the Executive Branch whose sole mission is to assist, advise and advocate for the small businesses of America. The Committee will continue to work to see that this mandate by the SBA to small business is being met.

### A. THE SBA BUDGET

Consistent with the effort to reduce spending in this Congress, the Small Business Committee, through the 1981 budget reconciliation process, passed cost-saving legislation that reduced the Small Business Administration's program levels by more than 40 percent.

The bill that emerged from the House/Senate Conference and was enacted into law, was a carefully drafted piece of legislation designed to reallocate limited resources, establish clear priorities, and set a new direction for the Agency.

The bulk of the cuts were made in the direct and disaster lending programs, in accordance with the Committee's desire to shift the emphasis of the Agency away from making individual loans, toward more productive programs. In deeping with this desire, the "503" program, which promotes local economic development, the Small Business Investment Company program, and the guaranteed lending program were maintained at adequate funding levels.

By refocusing the activities of the SBA in this manner, the comittee believes that, dollar for dollar, more jobs will be created, more expansion of healthy businesses will be undertaken, and more help will be directed where it is really needed. Ultimately, the Committee believes these structural changes will make the SBA a stronger, more effective Agency.

A summary of the major legislative changes in the SBA programs adopted in the Reconciliation Act follows:

On disaster lending:

The principle responsibility for farm disaster lending was placed with the Farmers Home Administration.

Homeowners, as well as business, must now comply with a credit elsewhere test when applying for disaster loans. For homeowners unable to receive credit elsewhere, the interest rate is set at one-half the government's cost of money, plus up to 1 percent, but not to exceed 8 percent. Homeowners who can get credit elsewhere must pay at the full cost of money to the government, plus up to 1 percent.

Previously, disaster loans to homeowners were given at 3 percent interest on the first $50,000 of assistance, regardless of ability to obtain credit elsewhere.

Businesses able to get credit elsewhere must now pay the prevailing market rate on interest for a maximum term of three years. For businesses not eligible for credit elsewhere, disaster loans are be given at a rate not to exceed 8 percent. Businesses will be eligible for loans up to 85 percent of an uninsured loss.

Previously, interest rates for businesses unable to get credit elsewhere were set at 5 percent. Businesses able to get credit elsewhere borrowed at an interest rate set at the government's cost of money, plus up to 1 percent. Businesses were eligible for loans up to 100 percent of an uninsured loss.

The following changes were made in SBA business lending programs:

Interest rates on all direct business loans would be set at the government's cost of money, plus up to 1 percent, except in the case of loans to the handicapped individuals or organizations for the handicapped. That rate remains at 3 percent.

A uniform maximum limit of $500,000 per borrower has been established on guaranteed loans. Maximum maturity of loans was set at 25 years, with longer periods set for loans used for construction or to acquire real estate.

A mandatory 90 percent guarantee has been imposed for guaranteed loans of $100,000 or less. Guaranteed loans of more than $100,000 up to $715,000 must be guaranteed between 70 percent and 90 percent, and guaranteed loans over $715,000 must receive a guarantee of less than 70 percent.

Authorization levels for fiscal years 1982, 1983 and 1984 were set at the following:

[In millions of dollars]

| | 1982 | 1983 | 1984 |
|---|---|---|---|
| Direct loans | 230 | 230 | 230 |
| Guaranteed loans | 3,300 | 3,300 | 3,300 |
| Pollution control guarantees | 250 | 250 | 250 |
| Surety bond guarantees | 1,400 | 1,400 | 1,400 |
| Salaries and expenses | 227 | 233 | 239 |

## B. S. 2408, THE SMALL BUSINESS VENTURE CAPITAL ACT

S. 2408, the "Small Business Venture Capital Act of 1982", was introduced by Senators Weicker and Nunn on April 21, 1982, and referred to this Committee.

This bill proposed amendments to increase the program ceiling for Small Business Investment Companies (SBIC's) from $160 million to $225 million for fiscal years 1982–1984; increase the program ceiling for Minority Enterprise Small Business Investment Companies (MESBIC's) from $35 million to $41 million for fiscal years 1982–1984; and increase the program ceiling for the Economic Opportunity Loan (EOL) program from $60 million to $70 million for fiscal years 1982–1984. In addition, the bill proposed to expand the SBA Inspector General's statutory audit cycle of SBIC's and MESBIC's from at least once annually to at least once every two years.

Two other related bills were also referred to the Small Business Committee. One bill, S. 2060, was introduced on February 3, 1982, by Senator Nunn. That bill would have increased program levels for the MESBIC program from the current law level of $35 million to $45 million in fiscal years 1982 and 1983.

A second bill, S. 2409, was introduced on April 21, 1982, by Senator Weicker, by request of the Administration. That bill would have increased the program ceiling for the MESBIC program from $35 million to $41 million in fiscal years 1982 and 1983. In addition, the bill would have raised the program level for the Economic Opportunity Loan program from the current law level of $60 million in guarantee authority to $100 million in fiscal year 1982, and to $167 million in fiscal year 1983.

On May 13, 1982, the Committee reported S. 2408. This bill was not, however, acted upon by the full Senate.

As reported by the Committee, the bill contained the original provisions of S. 2408, along with the following Committee amendments:

1. An amendment to the statutory authority for the surety bond guarantee program to give SBA greater latitude to deny liability in claims where the surety company is in material breach of its contractual obligations with SBA.

Existing section 411(e) of the Small Business Investment Act, adopted in 1978, states clearly that SBA will be relieved of liability on a surety bond in only two instances:

(1) when the surety obtained the guarantee, or applied for reimbursement, by fraud or material misrepresentation; or

(2) when the total contract at the time of execution of the bond exceeds $1,000,000.

At Committee hearings on the program, SBA officials testified that, in their view, the conference report explaining Congressional intent in the adoption of this provision was unnecessarily restrictive, and tied the Agency's hands even when there was a material breach of the contract by the surety.

They expressed concern that the agency may be precluded from denying liability for any reason but the two presently enumerated in the statute.

Accordingly, the agency recommended legislation that would permit the denial of claims in two additional instances:

(1) when the surety has breached a material or condition of the surety bond guarantee or agreement; and

(2) when the surety has substantially violated the regulations established by SBA.

The Committee agreed that SBA should have the authority to deny claims when there is a material breach of the surety bond quarantee or agreement or a substantial violation of the agency's regulations. While it is arguable that other provisions in the surety bond statutory authority permit the agency to fully accomplish their recommended action, the agency's recommendations were adopted to make clear SBA's authority to deny liability in these additional instances.

2. An amendment dealing with the SBA Pollution Control Equipment Contract Guarantee Program.

This amendment to the Small Business Investment Act of 1958 would have insured that SBA, subject only to the existence of qualified contracts, would enter into pollution control equipment guarantees of not less than $150 million for each of fiscal years 1982 and 1983 and not less than $175 million for fiscal year 1984. It would also have insured that SBA would not decline to issue guarantees on contracts financed through the use of tax exempt industrial revenue bonds. Furthermore, the amendment included a provision so that qualified applications pending on September 30, 1982, would be carried over and funded in fiscal year 1983, in the same manner and under the same funding levels as if they were funded in fiscal year 1982. This amendment also provided that the amendment should apply to applications pending at SBA as of January 1, 1982, or received after December 31, 1981.

By amendments in 1976 to the Small Business Investment Act of 1958, Congress authorized the Small Business Administration to guarantee 100 percent of the payments due from eligible small businesses under qualified contracts for the planning, design, financing or installation of pollution control facilities or equipment mandated by governmental pollution control regulations. Contract financing is normally obtained from the proceeds of the sale of tax exempt bonds issued by state or municipal authorities.

By using tax-exempt, SBA-guaranteed, pollution control revenue bonds, SBA cooperates with commercial and investment banks and local and state authorities to provide access to long-term, low-interest financing available to eligible small businesses.

The Committee has extensively reviewed the benefits of this program. A May 1981 oversight hearing, and testimony received by the Committee at its February 23, 1982 review of the President's fiscal year 1983 budget, reconfirmed that this is one of the most successful Small Business Administration programs.

Since the 1976 initiative, there has not been a single loss in the program. The initial $15 million capital contribution to the Pollution Control Bond Revolving Fund has more than doubled through both fees charged for guarantees, and agency investments of idle funds.

The Congress has recognized the sound financial basis for this program, as well as the crucial gap it fills in making financing available to eligible small business for mandated, non-productive, pollution control equipment. For example, in the Omnibus Reconiliation Act (P.L. 97-35), the Congress increased the maximum guarantee level for this program to $250 million. During the Senate's consideration of the fiscal year 1982 Commerce, Justice Appropriations Act (H.R. 4619), the Senate agreed to an amendment offered by Senators Hayakawa and Levin to establish minimum commitments for this program.

However, in January 1982, the Small Business Administration announced that, for the balance of fiscal year 1982, and for fiscal year 1983, the Agency would limit its guarantee commitments to $150 million. In addition, the Agency announced that none of the guarantee authority would be used for guaranteeing contracts financed with tax-exempt financing vehicles.

By supporting this proposal, the Committee restated its support for an adequate fiscal years 1982 and 1983 program level for the Pollution Control Bond program, and permit a modest growth in fiscal year 1984.

The Committee has consistently viewed the continued availability of the guarantee of contracts financed with tax-exempt financing instruments to be equally important. Repeated testimony of small businesses, bankers, underwriters, and state pollution control financing agencies overwhelmingly demonstrates the importance of small businesses' continued access to this small, but crucial source of guarantee authority. The Committee's adoption of this amendment is a reaffirmation of its judgement that it is sound public and fiscal policy to continue to permit small businesses which are forced to install nonproductive pollution control equipment access to this important (and often only) source of capital.

3. An amendment to establish minimum program authority for the Small Business Administration's guaranteed programs.

The amendment provided that the Small Business Administration shall enter into commitments to guarantee loans, debentures and other types of financial assistance in the full amounts provided by law, subject only to the availability of qualified applications, and limitations contained in appropriations Act.

This amendment specifically prohibited SBA from administratively reducing guarantee loan levels established in law. Reductions would be effective only if the Congress subsequently approved, through appropriate action, recommendations for reductions submitted to the proper Committees by the executive branch.

Under this amendment, the Small Business Administration would continue to enter into commitments to guarantee applications only with applicants who are qualified under the statutory authority establishing such guarantee program and the Administration's implementing rules and regulations.

This amendment also provided that the Small Business Administration will enter into commitments to guarantee in the full amounts provided by law, further subject only to limitations contained in appropriation Acts.

On November 5, 1981, the Reagan Administration announced a unilateral, government-wide reduction of previously authorized new federal loan guarantee commitments for fiscal year 1982 by $20.3 billion. For the Small Business Administration, this announcement reduced the levels for guaranteed loans in the Business Loan Investment Fund (BLIF) to $2.835 billion from $3.3 billion; the Surety Bond Guarantee Program to $1.080 billion from $1.4 billion; and the Pollution Control Bond Guarantee Program to $50 million from $250 million. This overall reduction in the Small Business Administration's loan guarantee authority to $985 million is almost 20 percent of the $5 billion in loan guarantee authority provided to the Small Business Administration by Congress in the Omnibus Reconciliation Act of 1981.

While the Committee recognized the Administration's legitimate concern over the impact of federal credit activities on the Nation's financial markets, the Committee could accept unilateral administrative reductions in the Small Business Administration's other guarantee program levels enacted by Congress. To allow administrative reductions of Small Business Administration loan guarantee authority would negate the priorities this Committee, the Congress, and the President have previously jointly established in law for the Small Business Administration.

Moreover, to allow these reductions to remain in effect through administrative action only would disregard the actions which this Committee initially took to set guarantee program levels for the Small Business Administration, and the actions of the Appropriations Committees to support these levels.

It was of course, not the Committee's intent that SBA be required to enter into commitments where guarantee authority is not being utilized because of an absence of applicants, or where applicants do not fully qualify for such assistance.

### C. SBA'S 503 CERTIFIED DEVELOPMENT COMPANY PROGRAM

The Small Business Administration's 503 Certified Development Company Program was enacted July 2, 1980 as a part of P.L. 96-302. Under the section 503 program, SBA is authorized to guarantee debentures issued by qualified development companies to finance the purchase of land, plant and equipment, i.e., fixed assets, for the expansion of an identifiable small business concern. By law, 503 loans can be for as much as 50 percent of a project's costs up to $500,000. The other 50 percent must come from the private sector, usually the small business concern and a bank. The purpose of the program is to leverage the SBA guaranteed loan to encourage the private sector to make long-term capital available to small businesses on reasonable terms in order to create and retain jobs in local communities.

On September 28, 1982, the Subcommittee on Urban and Rural Economic Development, chaired by Senator D'Amato, held a hearing on SBA's Economic Development Program, focusing on the section 503, Certified Development Company Program. The purpose of the hearing was to review the SBA's implementation of the new program, and to examine the Administration's policy of not permitting tax-exempt Industrial Revenue Bonds to be used in conjunction with 503 projects. The Committee was particularly concerned that in two years of operation, the SBA had spent only a fraction of the funds appropriated by Congress. Other than the fact that the program was still fairly new, the Administration's policy on tax-exempt financing was considered a major factor for the program's under-utilization of funds.

When the 503 program was established, the Conference Report to P.L. 96-302 stated:

> SBA should not disapprove the guarantee of any debenture, or any loan made with the proceeds of a debenture issue, solely because the proceeds would be used in a project whose other sources of financing include, or are collateralized by, tax-exempt industrial revenue or development bonds.

Consistent with the Conference language, SBA regulations, 13 CFR Part 108.503-4(c), state:

> . . . SBA may participate in projects whose other source of financing include, or are collateralized by tax-exempt obligations. Further, loans made with the proceeds of 503 debentures may be subordinated to such obligations.

SBA's instructions to the field, however, stated that "SBA may not participate in projects whose other source of financing include, or are collateralized by, tax-exempt obligations." (Standard Operating Procedure Manual 50-22 para. 23.) Committee staff investigation disclosed that SBA had adopted this policy, contravening the Congressional intent, at the direction of OMB in coordination with the Treasury Department. During Executive Branch consideration of SBA's FY 1982 budget, an Office of Management and Budget (OMB) memorandum response to SBA's request under the heading of significant policy determinations state:

> Continuation of the Certified Development Company Debentures Program, provided that SBA develops procedures—satisfactory to OMB and Treasury—that preclude indirect guarantees of tax-exempt securities.

Administration Spokesman, Roger Mehle, the assistant secretary of domestic finance at the Department of the Treasury, explained the Administration rationale for the policy at the September 28, hearing:

> First, placing the credit of the United States behind a tax-exempt obligation creates a security that is superior to direct obligations issued by the U.S. Treasury and is contrary to the spirit of the Public Debt Act of 1941, which prohibits direct issuance by Federal agencies of obligations

> the interest on which is exempt from Federal income taxation.
>
> Second, Federal guarantees of tax-exempts also have adverse effects on the municipal market because they create securities which are superior to all other tax-exempt securities issued by State and local entities. Consequently, such guarantees add to the pressures on the municipal bond market, crowd out other less creditworthy municipal borrowers, and increase the borrowing costs of all municipal borrowers.
>
> Finally, a guarantee of a tax-exempt obligation is an inefficient means of Federal financing because the revenue loss to the Treasury greatly exceeds the interest benefits to the borrower of tax exemption.
>
> These arguments against the Federal guarantee of tax-exempt obligations apply regardless of whether the guarantee is direct or indirect. In the case of the SBA section 503 debentures, while the tax-exempt obligations would not be directly guaranteed by the Federal Government, they would be effectively secured by the subordination of SBA's interests to the interests of the holders of the tax-exempts. That is, subordination of the Federal Government's interest would give the tax-exempt securities preferred status in the event of a default. The holders of the tax-exempt obligations would be paid in full before there would be any payment on the subordinated obligations guaranteed by SBA. SBA would be taking all or virtually all of the credit risk, and the holders of tax-exempt securities would thus be effectively guaranteed by the Government. As we have indicated, the Administration is strongly opposed to any such Federal guarantees of tax-exempt obligations and has acted to prevent them by adopting the current polcy on subordination under the section 503 program and also by placing limitations on the pollution control guarantee program.

Mr. Mehle went on to explain that:

> The Administration would not object, however—and I think this is the essence of this discussion—to a combination of an SBA-guaranteed 503 debenture and tax-exempt securities, so long as the SBA guaranteed debenture is in at least a parity position.

SBA Administrator Sanders expressed SBA's position, stating:

> We do not oppose participation in projects where the source of financing other than the guaranteed debenture is from tax-exempt industrial revenue or development bonds. Rather, our opposition occurs when that financing is in a senior lien position to the SBA guaranteed debenture. We believe this position is not in violation of the statutory intent set forth in the conference report to Public Law 96-302.
>
> We are prepared to clarify our regulations and procedures to allow participation so long as the SBA guaranteed

debenture is in at least a parity position. This will allow small business to have access to tax-exempt financing and SBA guaranteed debentures for the same project.

Witnesses representing Certified Development Companies (CDC's) and banks experienced with the program were not encouraged by the Administration's policy. They felt the policy had inhibited the development of the program. With respect to the parity position, they expressed skepticism. Scott Berman, President of Chicago's Lawrence Avenue Development Corporation, and a lawyer, stated:

> . . . it would not be possible or practical in all States to record two liens simultaneously that would share the same status on a loan. I think one would have to be subordinated to the other in spite of agreements that might be made from one secured parity to another.

Roger Peterman, President of Commonwealth Small Business Development Corporation of Kentucky, said the "parity position" seemed to be based on,

> . . . a total misconception or lack of knowledge of the reality of these securities in the marketplace. There would not be any market, any public market, for an IDB that had a 503 subordinated to it. It would be a security that has to be held by that bank.

Don Gallagher, Vice President of Chemical Bank, Melville, New York, expressed serious reservations that even a bank would consider such a proposal. As he explained, "[banks] are there to make first mortgages, . . . They will not share that position with anyone."

Mr. Gallagher also shared the view that reversing the current policy, particularly with respect to the 503 program, would be a vehicle to increase banks' loans and investments in small businesses. Gallagher thought the principle of the 503 program was to encourage banks to make long-term financing available for smal businesses. Providing the use of tax-exempt financing would make other bank investment funds available, in some cases doubling the amount of money available, he said.

The Committee also received testimony on some of the recommendations for administrative changes in the program made by the National Association of Development Companies, a national association of CDC's.

### D. NOMINATIONS

In accordance with its legislative responsibilities, the Committee, during the 97th Congress, considered and confirmed the nominations of four appointees to the Small Business Administration. These were: Michael Cardenas, to be SBA Administrator; Paul Boucher, to be SBA Inspector General; Frank Swain, to be SBA Chief Counsel for Advocacy; and James Sanders, to be SBA Administrator (upon the resignation of Mr. Cardenas from that post).

*Michael Cardenas*

The nomination of Michael Cardenas, a former partner in the Fox & Company accounting firm, and a resident of Fresno, California, was received by the Committee on March 19, 1981. On March 23, 1981, the Committee held a hearing on the nomination and received testimony from Mr. Cardenas, Senator Hayakawa, and Representatives Jerry Lewis and Charles Pashayan Jr. of California. The following day, March 24, the Committee met, and by a unanimous vote, reported the nomination to the Senate. On March 26, 1981, the nomination of Michael Cardenas to be Administrator was confirmed by the full Senate. On February 3, 1982, Mr. Cardenas submitted his resignation to the President.

*Paul Boucher*

Paul Boucher, of Virginia, served as Inspector General from June 27, 1979 to January 20, 1981, when he was terminated by the incoming Administration, along with all other inspectors general. On May 12, 1981, he was renominated by President Reagan to the post. On June 19, 1981, the nomination of Paul Boucher to be reappointed as Inspector General of the Small Business Administration was confirmed by the Senate.

On July 4, 1982, the Small Business Committee was deeply saddened by the tragic accidental death of Mr. Boucher at age 40. In a statement on the Senate floor, Senator Weicker remembered Mr. Boucher as "one of the finest public servants this city has known." Senator Nunn called him "an outstanding employee" and "a man of great integrity."

*Frank Swain*

Frank Swain, a native of Corning, New York, and a resident of Washington, D.C., was nominated to the position of Chief Counsel for Advocacy on July 23, 1981. On July 30, 1981, the Committee held a hearing on the nomination, and received testimony from then-Administrator Michael Cardenas, William Dennis of the National Federation of Independent Business, and Peter Webster, president of the Smaller Business Association of New England. Immediately following the hearing, the Committee, by a unanimous vote, ordered the nomination favorably reported to the Senate. On July 31, 1981, Mr. Swain was confirmed by the Senate as Chief Counsel for Advocacy to the Small Business Administration.

*James Sanders*

James Sanders, of San Jose, California, was nominated by President Reagan on February 4, 1982, to succeed Michael Cardenas as Administrator of the SBA. Mr. Cardenas resigned from that post on February 3, 1982. Mr. Sanders had been serving as Associate Administrator for Management Assistance at SBA. On March 9, 1982, the Committee held a hearing to consider the nomination. Testimony was received from Senator Hayakawa and Representative Norman Y. Mineta of California. On March 25, 1982, the Committee met, and by unanimous vote, ordered Mr. Sanders' nomination favorably reported. On March 29, 1982, he was confirmed by the Senate as Administrator for the Small Business Administration.

### E. SMALL BUSINESS ADMINISTRATION OVERSIGHT

#### *1. Attempted unauthorized expansion of the 8(a) pilot program*

*Summary*

On December 19, 1980, President Jimmy Carter signed an Executive Memorandum to include three additional Federal agencies in the Small Business Administration's 8(a) Pilot Program. Under P.L. 95-507, which established the Pilot Program, the President did not have authority to designate more than one agency as a participant in the program.

On January 12, 1981, Committee staff learned of the Presidential Memorandum, and immediately initiated an investigation into the circumstances surrounding the memorandum.

The Committee's review of this matter showed that there had indeed been an attempt to circumvent Congressional intent.

On January 23, 1981, the Committee released its findings at a hearing. As a result, SBA stopped its plan to expand the program, and notified the White House that the President did not have legal authority to designate additional agencies as participants in the Pilot Program.

*History*

Section 8(a) of the Small Business Act authorizes the Administrator of SBA to enter into contracts with Federal agencies and to then subcontract the work to socially and economically disadvantaged small businesses. Under this program, the Administrator of SBA requests that certain procurement needs be reserved for award to small businesses certified under the 8(a) program.

Prior to 1978, the 8(a) program, as administered by SBA, functioned primarily to provide minority businesses with an opportunity to contract with the Government. The program lacked any specific mission beyond contract assistance and thus failed to promote any appreciable business growth. Without achieving some degree of business development, minority firms were unable to compete successfully in the private sector and failed to graduate from the 8(a) program.

In 1978, Congress enacted P.L. 95-507, which restructured the 8(a) program, created the Office of Associate Administrator for Minority Small Business and Capital Ownership Development, and placed greater emphasis upon business development. The SBA was required to provide contract assistance as well as managerial, technical and financial aid to qualified minority firms. In addition, P.L. 95-507 authorized the President to designate, on a trial basis, one agency with which SBA would have increased authority to select and negotiate any contract requirements that SBA deemed appropriate for inclusion in the 8(a) program.

Historically, a large percentage of the contracts awarded under the 8(a) program were in the service and supply areas. The pilot program created by P.L. 95-507 was specifically designed to provide increased opportunities for minority firms to enter into high-volume, high technology contracts with Federal agencies. The significant language of P.L. 95-507, section 202(a) states:

> It shall be the duty of the Administration (SBA) and it is hereby empowered whenever it determines that such action is necessary or appropriate . . . to enter into contracts with such agency, as shall be designated by the President . . . to furnish articles, equipment, supplies, or to perform construction work for such agency. In any case in which the Administration certifies to any officer of such agency having procurement powers that the Administration is competent and responsible to perform any specific procurement contract to be let by any such officer, such officer shall let such procurement contracts to the Administration upon such terms and conditions as may be agreed upon between the Administration and the procurement officer . . .

Section 202(a) further stipulated that no contract could be entered into under the authority of this Act after September 30, 1980.

On January 10, 1979, President Carter designated the Department of the Army (DOA) as the pilot agency. However, SBA and DOA were unable to enter into an interagency agreement setting forth the formal terms and arrangements for their joint implementation of the pilot program until May 1979. The initial award of a contract selected for the pilot program was not completed until September 1979, nearly one year after enactment of the pilot authority. Due to these delays in implementation of the pilot program, and Congressional concern that the program had not been fully tested, Congress enacted P.L. 96-481 in October, 1980, which, among other things, extended the pilot program until September 30, 1981.

### *Scope of investigation*

The Committee's review of the proposed expansion of the 8(a) Pilot Program included interviews with officials at the Departments of Energy, Army, Transportation and the National Aeronautics and Space Administration (NASA), the agencies that would have been included in an expansion of the pilot program, and at the SBA, GAO, and White House. Committee staff conducted a series of interviews with the procurement representatives in each of the agencies named in the December 19 memorandum. Staff also met with the officials responsible for minority programs in each of these agencies. Finally, Committee staff interviewed White House Domestic Policy staff and Office of Federal Procurement Policy officials who originally drafted the memorandum.

Throughout the investigation of the origin and impact of the December 19 memorandum, staff members were in frequent contact with SBA Inspector General Paul Boucher, Acting SBA Administrator Roger Jones and program officials responsible for the agency's Minority Small Business Capital Ownership Development (MSB-COD) program.

### *Findings*

On January 12, 1981, Committee staff learned that President Carter had issued a memorandum extending the 8(a) pilot program to three additional agencies. The memorandum, addressed to the Secretaries of the Army, Transportation, and Energy and to the Administrators of NASA and SBA stated:

> October 22, 1980, I am required to designate agencies to participate in the SBA pilot procurement program. By this memorandum, I am officially designating the Departments of the Army, Transportation and Energy, and the National Aeronautics and Space Administration to participate in this program . . . I know I can count on each of you to see that this program is initiated in your agency before my Administration concludes on January 20, 1981.

This memorandum was in direct contravention not only of Congressional intent, but also of existing law. Under P.L. 95-507, the President was authorized to designate one agency for participation in the pilot program. The Department of the Army was so designated in January 1979. Public Law 96-481 did not require the President to re-designate a participating agency nor allow expansion of the pilot program to additional Federal agencies. Rather, this legislation simply extended for one year the authority of P.L. 95-507.

The Committee's investigation revealed that officials at SBA assisted the Administration in the attempt to expand the program despite the fact that such an action was beyond the scope of existing law. Of particular concern to some Members was the fact that the Departments of Energy and Transportation and NASA entered into interagency agreements necessary to implement the pilot program expansion after SBA's Inspector General had notified them of the impropriety of the December 19 memo. The Committee's review indicated that the Deputy Administrator of the SBA, William Mauk, was aware as early as March 1980, that the White House was considering expansion of the pilot program to additional agencies; however, he made no effort to inform the President that this action was illegal. Only when faced with the prospect of the Committee's hearing did SBA acknowledge the impropriety of the December 19 memorandum, and recommend that the President rescind it.

### *2. SBA contracting procedures*

### *Summary*

On April 27 and 28, 1981, the Senate Small Business Committee held oversight hearings on the Small Business Administration's contracting procedures. The hearings resulted from a two-month staff investigation of SBA's internal procurement practices.

The investigation found that the agency's top management officials had acted with disregard of Federal Procurement Regulations. For example, an overwhelming majority of contracts were awarded on a sole-source basis, despite the basic premise of Government procurement that contracts be given on a competitive basis to the "maximum practicable extent." From Fiscal Year 1978 through

Fiscal Year 1980, 92 percent of all SBA contracts were sole-source awards.

Even so, the sole-source contracts were often improperly awarded; contracts were provided for work that could have been performed in-house, or that should not have been done at all. Many of the required justifications for these non-competitive contracts were unacceptable according to standards established by Federal Procurement Regulations.

There were examples of contracts being awarded to friends of agency officials after the officials applied pressure on subordinates to approve the procurements. In some cases, these same officials pressured the SBA contracting staff to circumvent Federal Procurement Regulations.

SBA program officials engaged in unauthorized business contacts with contractors, in violation of Federal Procurement Regulations.

Contractors were permitted to work on projects without written contracts or the knowledge of the SBA procurement office, and were paid for unauthorized work.

SBA officials indiscriminately used letter contracts, which, when properly utilized, expedite the award of a contract for emergency work. SBA continually provided letter contracts, which allow work to begin without a statement of work and before costs are negotiated, for projects which did not require expedition. One of these letter contracts resulted in SBA being billed for partial costs of a swimming pool, tennis court, Jaguar automobile, private school tuition, liquor, and other unallowable expenses.

The Committee's investigations and testimony at the hearings showed a pattern of favoritism in the award nof contracts which may have been indicative of criminal activity. Therefore, pursuant to the instructions of Chairman Weicker, the Committee's findings and a transcript of the hearings were referred to the Public Integrity Section of the Department of Justice for further investigation. The investigation closed with no resulting prosecutions.

### *The nature of SBA contracting*

SBA, like all agencies of the Federal Government, is authorized to procure from the private sector services or materials which are not otherwise available in the Government. These procurements must be necessary for operating SBA under its legislative mandate.

Committee staff examined SBA contract procedures for fiscal year 1978 through fiscal year 1980. During this time, SBA awarded $14.2 million in procurement contracts for goods and services for the agency. These contracts had no relation to the SBA Government-wide contract set-aside programs, and included all awards where SBA itself acted as the procuring agency.

Some of the contracts were for consulting, which includes personal services to augment SBA staff, management studies, and research. Other contracts were for materials such as manufactured items. The majority of the awards were service contracts, which include computer services, maintenance, and other services required for the day-to-day operation of SBA.

All government procurement offices are required to seek competition in the award of contracts, except in the case of a national emergency; in the event of a special urgency; where one contractor possesses a unique product or service unavailable from other sources; or in the event that more than one bid is not received on an advertised request for bidding.

Formal advertisement for bids is the preferred method of soliciting competition. Formal advertising requires the agency to prepare detailed specifications of the required work, which is published as an invitation for bids. The lowest responsible bidder should receive the award after submitted bids are reviewed by the agency's procurement and program officials.

Federal agencies are encouraged to accept unsolicited proposals for contracts. This occurs when a contractor submits an original idea for a project that would benefit an agency in meeting its legislative authority. If the contractor who submits the unsolicited proposal has a unique capability to perform the work, then the contractor may receive a sole-source award.

Program officials may receive unsolicited proposals and may discuss contract specifications with bidders. However, only an authorized agency contracting officer may conduct any business negotiations involving a contract. A program official cannot approve a contract or discuss costs on a contract without the knowledge or acceptance of contracting officers.

Work on a project cannot begin without a written contract approved by the Office of External Awards and the appropriate program office.

### *Scope of investigation*

In early February 1981, Committee staff was informed by several SBA officials that the Deputy Administrator of the agency, William H. Mauk, Jr., had pressured procurement officers to award certain controversial contracts in the waning weeks of the Carter Administration. In the course of checking these allegations, staff discovered numerous improprieties involving the award of contracts, and decided to conduct a full-scale investigation of contract activities at SBA.

The investigation began with a lengthy examination of individual sole-source contract files. Contracts examined by the Committee were for such projects as economic research, development of management-employee incentive plans, establishment of an experimental district office program, management of program conferences, management assistance to small business contractors, and analysis of Federal policy on small business issues.

Upon completion of this process, contracts which appeared suspicious in nature were selected for comprehensive reviews. In each case, all SBA contracting and program staff involved in each procurement were interviewed, and files that were related to the contracts, but may not have been in the files of the Office of External Awards, were obtained and reviewed by Committee staff. These included supplemental memoranda and correspondence held by contractors or program officials.

During the investigation, Committee staff worked closely with auditors and investigators of the SBA Office of Inspector General (IG). The IG had conducted audits or investigations of several contracts reviewed by the Committee.

Audits conducted by the Defense Contract Audit Agency, which conducts audits of contracts at all defense agencies, were also used as part of the Committee's investigation.

### *Response to findings*

As a result of the Committee's investigation, SBA's management has committed itself to abiding by Federal Procurement Regulations. Non-competitive awards almost immediately dropped to less than 50 percent of all procurements, and that percentage has been maintained.

## *3. SBA disaster loan program*

### *Summary*

In May 1981, the Senate Small Business Committee began a review of the SBA Disaster Loan Program. As a result of meetings with the SBA Inspector General (IG), Committee staff became aware of serious management problems in the program. In addition, the General Accounting Office released a report on January 26, 1981, which criticized SBA's administration of disaster loans made following a blizzard in Massachusetts in 1978. The Committee review found that the program had been riddled with mismanagement and abuse and that applicants were receiving duplicate, excessive and improper loans. Borrowers had received loans for losses they had not experienced; had deposited loan proceeds in high interest bearing notes, had used them to purchase land, had invested them in the commodities market and had received loans for the same loss from different Federal agencies. Frequently, SBA employees unwittingly violated agency regulations and federal law by encouraging borrowers to seek duplicate loans.

The agency also failed to effectively monitor and service its loan portfolio, thus permitting borrowers to remain delinquent on loan payments for long periods of time.

The Committee review of this program culminated in two days of hearings on September 9 and 10, 1981, at which time officials from SBA testified that possibly hundreds of millions of dollars had been lost due to waste, fraud and abuse. At that hearing, in response to the findings of the Committee, representatives of the Office of Management and Budget authorized SBA to establish a 99-person task force to assist SBA in identifying and collecting improper loans. In addition, SBA revised its procedures to ensure that similar problems would not occur in the future.

### *History*

The Small Business Act authorizes SBA to make loans to small businesses and to homeowners who have suffered damage as a result of natural or unexpected economic disasters. In general, these loans are provided at below market interest rates with extended payment schedules which permit the borrower to have his home or business returned to its previous condition.

Businesses and homeowners become eligible to receive SBA disaster loans upon determination by either the President, the SBA Administrator that a disaster has occurred. At that time, individuals submit applications to SBA offices which are established at the disaster site.

In 1977, as a result of a severe drought which had devastated many farming communities throughout the United States, the SBA General Counsel determined that individual farmers qualified for SBA disaster assistance for losses resulting from drought. This ruling opened the floodgates of the disaster loan program. This opportunity to receive loans, which at that time carried a 3 percent rate of interest, resulted in an increase in disaster assistance loans from 20,408 in 1976, to 68,404 in 1980. Expenditures under this program increased from $250 million in 1976 to $2.5 billion in 1980. The Disaster Loan Portfolio now totals in excess of $6.3 billion, which represents 37 percent of the entire SBA Loan Portfolio. Of this $6.3 billion portfolio, in excess of $3 billion represents farm disaster loans. Because such a large percentage of disaster loans were for farm disasters, the Committee investigation was primarily focused upon farm loans.

In response to this massive increase in disaster loans, Congress enacted P.L. 96-302 in 1980, which made major changes in the SBA disaster loan program. The intent of this legislation was to remove SBA from substantial involvement in farm disaster lending. The Committee believes that this reform places the farm disaster loan program under the appropriate agency and has effectively prevented the award of duplicate loans, one of the problems which had previously plagued the disaster lending programs. This legislation, however, did not remove responsibility from SBA for the administration of the $3 billion in farm-related loans made prior to 1980. The primary concern of the Committee was evidence that SBA lacked the resources and ability to effectively manage and collect this huge loan portfolio.

### *Scope of review*

Staff began its review with an examination of a series of limited audits and investigations conducted by the SBA Inspector General, the Justice Department and the Department of Agriculture. These included the following:

> An audit performed for the SBA IG by R. H. Ritchey, a private accounting firm. Audits were conducted on 439 farm disater loans amounting to approximately $166 million. The audit covered 24 SBA District Offices in nine of the agency's ten regions. The loans were made during the years 1977 through 1979. The audit found $16 million in excess loan payments, duplicate loan payments, or apparently misused loan proceeds.
>
> A computer match prepared by the Offices of Inspector General at SBA and USDA to identify illegal duplicate disaster loans. This limited investigation reviewed 1300 loans files in 13 states, finding 119 illegal duplicate disaster loans amounting to $2.3 million.
>
> A Justice Department effort to prosecute some of the illegal loan cases. Although the Department made this effort a major priority of the Criminal Division in 1979, it was unable to prosecute a single case because SBA had so poorly handled the loan program. Prosecutors found that because of SBA's mismanagement, and because of its laxity in processing and ex-

plaining the government's rights and the borrower's obligations upon receipt of government loans, it would have been too difficult to prove criminal intent to a jury.

SBA IG criminal investigations of cases where farmers allegedly misused loan proceeds for such items as new homes or Certificates of Deposit. These cases were referred to several different U.S. Attorneys, who declined prosecution, again, because the agency mismanaged the program to such extreme degrees that it would have been impossible to prove criminal intent on the part of the borrower.

Staff continued the investigation by examining internal agency memoranda and conducting interviews with SBA personnel in the Central Office and in Region Four, a nine-state area based in Atlanta. Also interviewed in the field were several farmers in three states—Georgia, South Carolina, and Mississippi—who were cited by the SBA IG or the Justice Department for improprieties connected to their disaster loans. Several more farmers were interviewed by telephone.

Over a three-and-a-half month period, the Committee's investigative staff examined more than 450 audits and investigations, hundreds of pages of supplemental documentation, and interviewed dozens of people involved in the Farm Disaster Loan program.

### *Findings*

The Committee found that the abuses in the program were concentrated into three main areas; excess crop yield, where borrowers received loans in excess of their actual loss; misuse of proceeds, where borrowers spent the loan proceeds for unauthorized purposes; and duplicate benefits, where borrowers received disaster loans from more than one federal agency for the identical loss.

Excess crop yield occurred when a borrower overestimated the amount of his loss due to disaster. Due to the procedures SBA followed when determining a borrower's loan eligibility, many individuals received low interest loans in excess of their actual loss. For example, one farmer estimated his loss as a result of the disaster at $476,000. The actual loss was determined to be approximately $143,000. Regardless, SBA provided this farmer with a loan for the amount of the estimated loss and thus provided him with a $333,000 loan for a loss he never sustained. The SBA IG indicated that the agency's limited audit uncovered $6.7 million in such excess loan payments.

Misuse of proceeds occurred when the borrower used the SBA loan for unauthorized purposes. The most frequent abuse revealed by the various audits occurred when borrowers deposited the loan proceeds in high interest bearing accounts. Rather than using the loan for the intended purpose of replacing lost or damaged crops, these borrowers deposited the money and collected the difference between the interest rates the government charged, and the amount these deposits yielded. In other instances, borrowers used the disaster loans to purchase land, refurbish a house, invest in the commodities market or repay a home mortgage.

The final area of abuse occurred when borrowers received disaster loans from more than one federal agency. In some instances, borrowers were attempting to receive the lowest rates interest and in other cases were applying to all federal agencies providing assistance. In several cases, however, borrowers were clearly attempting to defraud the government. Federal law prohibits borrowers from receiving funds from more than one federal agency for the same loss. The various audits conducted by the SBA, USDA and the Justice Department revealed approximately $5 million in duplicate benefits.

These findings resulted from the Committee's review of approximately 450 audits. These audits, however, were from a universe of only 5,600 loans. Currently, the SBA disaster loan portfolio consists of an excess of 74,000 loans. The abuses and potential losses cited at the hearing and in this report, therefore, were identified after examination of only a small fraction of all disaster loans.

### *Collection*

Collection of the excess payments made under the program, which is authorized by Federal law and SBA regulations, was minimal prior to the Committee's investigation and scheduled hearing. The individual District Offices had been reluctant to demand repayment of improper loan proceeds due to a memorandum from the SBA General Counsel in Region Four. In this memorandum, the counsel noted that:

> Loan authorizations required only that SBA be advised (of duplicate and excess payments), no further actions were required of the borrower . . . We know what was intended but we did not nail it down. In my opinion, a demand (for repayment), . . . would not be sustained by a court in those circumstances.

This opinion by the Regional Counsel confirmed the interpretation offered by the Columbia District Office, which stated:

> The loan authorizations we used were worded in such a way as to be legally unenforceable because they require that SBA only be advised of disaster payments from other agencies and only be advised when yields and incomes exceeded expectations. The authorizations did not specifically require restitutional payments.

In addition, SBA's General Counsel maintained that the Agency did not have the authority under Title 42, USC 5155, to collect duplicate benefits, and that this authority rested solely with the Federal Emergency Management Agency (FEMA). Counsel further claimed that FEMA had "steadfastly declined" to delegate its collection authority to SBA so that SBA could legitimately initiate collection procedures.

In short, the Agency claimed that their own loan documents were inadequate and did not permit SBA to require repayment of excess and duplicate loans, and that interagency conflicts prevented them from utilizing Federal law.

Representatives of FEMA stated that SBA had never requested a delegation of authority. In addition, in response to an inquiry from Committee's staff, FEMA General Counsel George Jett stated that SBA does not require a delegation of collection authority to demand repayment of excess and duplicate loans.

> In my view, the Federal Government, . . . has a clear legal right and an obligation to collect any debt it is owed . . . I am of the opinion that the Federal agencies, including SBA, are authorized to pursue efforts to recover duplicative disaster loan payments for loans issued under the applicable statutory authorities.

Jett went on to indicate that FEMA had not even received a "request for a delegation instrument to institute collection action." His letter concluded that even though such a delegation was unnecessary, one would be immediately prepared if it was determined that such an action would facilitate the Agency's recovery actions.

### *Request to OMB*

The Committee's review of the SBA farm disaster lending program was initiated primarily to identify two areas; first, the amount of improper, excess, or duplicate loans which may have been made; and secondly, to determine if SBA had the ability and resources necessary to secure and collect these loans. At the Committee's hearing on this program in September, 1981, Paul Boucher, the SBA IG, estimated that $100 million in excess and duplicate loan payments might have been identified if the entire universe of 5,600 loans had been audited. Mr. Boucher went on to state that an audit of all 74,000 disaster loans in SBA's portfolio would probably have identified "several hundreds of millions" of dollars in excess and duplicate loan payments. Additionally, the Committee's investigation of this program concluded that the administration and servicing of the farm disaster loan portfolio by SBA personnel was seriously inadequate. Therefore, Chairman Weicker determined that the Committee should request a temporary allocation of additional personnel from the Office of Management and Budget (OMB) to identify and collect any excess and duplicate loans which were made following SBA's entrance into the disaster lending field.

During the September 1981 hearings on this program, the Committee received testimony from Edward L. Harper, Deputy Director of OMB, regarding the efforts OMB had made to improve the administration of the SBA disaster lending program. Harper stated:

> One goal at the Office of Management and Budget is to strengthen the management of this Small Business Administration's program generally and specifically . . . some of the things we have done is to approve 99 temporary employee positions (for the purpose of identifying, servicing and collecting excess and duplicate loans).

Harper indicated that OMB intended to assign these individuals to the Southeastern states, primarily SBA Region IV, in an effort to collect the greatest amount of excess and duplicate programs in the shortest time. Harper left open the option of rotating these employees to other areas if their collection efforts proved successful and remained cost-effective.

### *SBA action*

To a large degree, many of the problems associated with SBA's administration of the disaster loan were eliminated once USDA assumed the full burden for providing agricultural disaster assistance. However, in response to the findings of the Committee and the SBA IG, Administrator Michael Cardenas did institute some reforms in the management of the existing portfolio. Primary among these reforms was the proposal to alter the basic delivery system for disaster assistance. This new system would establish area offices which would be staffed by experienced, full-time disaster employees. If a disaster occurs, the responsible area office assumes full control for establishing and administering the disaster assistance in that area. Additional disaster employees may be drawn from the remaining areas as need requires. This system replaces one wherein the disaster office was staffed by temporary, often inexperienced, employees recruited at the scene of the disaster.

Area managers would be full-time disaster professionals responsible for all disaster activities within their assigned area and accountable directly to the SBA Central Office in Washington, D.C. This direct management system would eliminate many of the delays, inequities and bottlenecks which frequently plagued the previous disaster assistance efforts.

Concerning portfolio management, the individual District offices instituted an effort to identify and demand repayment on improper disaster loans. Letters were sent to borrowers explaining possible duplicate or excess loan payments and requesting the borrower to contact SBA to establish some type of repayment schedule.

The additional employees assigned to the collection and identification effort by SBA were to be coordinated by the Director of the SBA Office of Portfolio Management. These individuals would begin their effort in Region IV and move to different Regions based on the amount of total loans made in that area. As of August 1982, this task force had reviewed in excess of 12,000 loans and had identified approximately $10 million in questionable financings. Of this amount, $2 million has been repaid by the borrowers and SBA has received notes for an additional $2 million. Due to the poor financial condition of the borrowers, the remaining funds, approximately $6 million, will be repaid over the term of the original loan.

### *Conclusion*

In an effort to provide needed funds to farmers, SBA rushed into the farm disaster loan area prior to establishing proper procedures or guidelines. The results were predictable. In response to the massive increase in the size of the disaster program, Congress in 1980 enacted legislation removing SBA from the agricultural lending field. This Committee initiated a review of the disaster lending operation in response to reports that improper and fraudulent claims had been submitted by numerous applicants. Unfortunately, this review confirmed those reports. In addition, it opened up entirely new areas of inquiry, including the regulations, personnel resources, and servicing of the disaster portfolio.

As a result of oversight hearings held on September 9 and 10, 1981, SBA, in cooperation with OMB, USDA and DOJ, has taken steps to resolve many of the problems plaguing this program. More importantly, SBA has reorganized the disaster assistance program to prevent similar problems from occurring in the future. SBA has not been entirely successful in collecting duplicate and improper loan payments. In many cases, this is due to the fact that large numbers of borrowers are simply unable to repay significant sums of money in times of rising prices and falling profits. However, the Agency has identified approximately $10 million in duplicate or improper loans, confirming the indications discovered by the SBA IG and Committee staff. Finally, the positive response of SBA to the problems identified during this review has sent a clear signal to potential borrowers that the agency will no longer tolerate failures to comply with Federal regulations governing disaster assistance.

### *4. SBA direct loan program*

On August 31, 1981, the St. Louis Globe-Democrat published the first of a nine-part series of articles which examined the Small Business Administration's Direct Loan Program. This series, "SBA Loans: Fast Track to Failure," was the result of an extensive investigation by Globe-Democrat staff reporters Thomas Amberg and Michael Montgomery, and was highly critical of the program. The series concluded that 42 percent of the direct loans made by SBA between 1970–1978 ended in default and that, as a result, taxpayers had lost $571 million. The series further indicated that mismanagement by the SBA was the primary reason for this excessive loss rate.

In response to the allegations made in the Globe-Democrat series, Senator Alan Dixon requested that the Small Business Committee hold an oversight hearing on the Direct Loan Program. The Committee's review of this program indicated that the findings of the Globe series were essentially correct and that the policy governing the Direct Loan Program was in need of revision.

At the Committee's hearing on the Direct Loan Program on October 27, 1981, SBA Administrator Michael Cardenas testified that the Agency had revised its criteria for award of direct loans and in the future intended to maintain stricter controls over the program.

#### *History*

Section 7 of the Small Business Act established the direct loan programs and authorized SBA to make loans to small businesses. For the purpose of this Act, a business is considered small if "it is independently owned and operated and . . . is not dominant in its field of operations."

Loans made under this section of the Act are classified under three distinct headings.

1. A direct loan is made by SBA with no participation by a lending institution.
2. A guaranteed loan is made by a lending institution and carries SBA's guarantee to purchase an agreed-upon percent of the outstanding balance of the loan if it is declared in default.
3. An immediate participation loan is made by either SBA or a lending institution under an agreement requiring the other party to purchase a certain percentage of the loan immediately upon disbursement.

SBA regulations prohibit the award of a direct loan if the business qualifies for either of the other two forms of assistance. Direct loans necessarily carry a higher degree of risk than either guaranteed or immediate participation loans due to the fact that, in many cases, SBA is acting as a "lender of last resort" when approving direct loans.

The direct lending programs were designed by Congress to assist small businesses that are unable to obtain financing from other sources. In doing so, Congress tacitly accepted the fact that many such businesses were apt to fail and thus default on their loans. Congress accepted a high deferral rate as a necessary outgrowth of promoting small business development; however, it did not condone the indiscriminate award of loans to individuals who clearly had little chance of succeeding in their enterprise and eventually retiring their debt to the government.

Unfortunately, the SBA gradually instituted policies which frequently resulted in this situation. As Congress continued to increase funding for the program in the sixties and seventies, SBA developed a policy which put the emphasis on "getting the money on the street." Loan officers were encourgaged make more and more loans and in doing so, often failed to accurately determine the merit of the business applying for the loan. Promotions and job objectives at SBA were based on the number of loans an individual approved, rather than upon the number of loans which were repaid. This policy of quantity, rather than quality led to high default rates and to numerous instances in which loans were approved to totally unqualified borrowers.

The General Accounting Office (GAO) conducted reviews of the SBA 7(a) loan program in 1964, 1969, and 1976, and of the Equal Opportunity Loan (EOL) program in 1980. In each report, GAO concluded that SBA was not properly monitoring the program and was approving loans to unqualified businesses. In the 1976 review, GAO indicated that SBA was approving direct loans which were used to simply repay debts of the borrower; subjecting borrowers to hardship by failing to properly analyze financial documents; failing to verify the use of the loan proceeds; failing to aggressively follow up on delinquent borrowers and failing to provide management assistance. In short, this report concluded that SBA was inefficiently managing the business loan program at almost every turn.

The GAO review of the EOL program in 1980 indicated that SBA was experiencing similar problems in the award and administration of these loans. The EOL program was specifically designed to create new businesses, improve economic conditions in poor neighborhoods and to increase business ownership among minority group members. To achieve these ends, the criteria for approval of EOL's were less stringent than those for the regular 7(a) business loans. In particular, credit standards were more flexible and capital investment requirements were less strict. To be eligible for an EOL, the business' application for financing must have been rejected by two banks and been found unacceptable under the regular 7(a) business loan program. Loans made under this program represent approximately 45 percent of all direct loans made over the past 10 years.

The GAO report indicated that the program had little success in achieving its goal of promoting minority ownership of small businesses. From the inception of the program through fiscal year 1978, in excess of 62,000 EOL's totaling over $1 billion had been approced. However, more than 21,000 or 34 percent of these loans had been either charged off or placed in liquidation. A statistical sample of borrowers who had repaid their SBA loans between 1969 and 1978 at four major SBA district offices indicated that only 15 percent of these borrowers had succeeded in establishing an ongoing business. The GAO stated that as of August 1981, 35.8 percent of the EOL portfolio was either delinquent or in liquidation, and that losses on EOL's were expected to total approximately $342 million through fiscal 1980. This report went on to cite several additional problems:

1. SBA's failure to properly analyze the needs and qualifications of loan applicants;
2. Incomplete goal systems which focused on lending in quantity rather than quality;
3. Insufficient financial and managerial assistance;
4. Excessive utilization of refinancing and deferment to maintain a loan in "current" status.

The report concluded that EOLs have not been an effective was to help disadvantaged individuals start or improve their businesses, and stated that:

> More borrowers have defaulted on their loans than have repaid them. Many who paid off their loans have not remained in business . . . (Many) borrowers with active loans . . . are in financial difficulty.

The report recommended that if program results did not improve, Congress should consider transferring funds for the program to an alternative Federal program.

*Summary*

The various examinations conducted by the GAO indicate that the direct lending programs have suffered from the lack of a coherent policy as well as mismanagement by Agency officials. As these programs increased in size, internal controls were weakened as the Agency attempted to achieve certain numerical goals at the expense of ensuring quality loans. In many cases, these actions have resulted in large losses for both the Agency and the individual borrower. The direct lending program at SBA achieved only limited success in establishing minorities in small businesses and assisting those businesses already in place.

*Scope of Review*

The hearing was held at the request of Senator Dixon in response to the articles published in the St. Louis Globe-Democrat. As Senator Dixon noted, "the purpose of this hearing is to provide the Committee with a range of opinions on the successes, the failures, the problems and the potentials of the direct loan program." Committee staff members reviewed the information which formed the basis for the Globe-Democrat series and independently confirmed the statistics presented in these articles. In addition, staff contacted some of the individual borrowers mentioned in the series and conducted interviews with the SBA district office staff in St. Louis. Staff also conducted extensive interviews with the program officials responsible for the direct loan programs in the SBA central office and withn loan officers stationed at various district offices throughout the country. Finally, staff met with respresentatives of the General Accounting Office and the SBA Inspector General's staff to discuss their past and current reviews of the various lending programs.

### *Findings*

The Globe-Democrat series presented an overview of the SBA direct loan program which focused primarily on six different areas. These included:

1. The default rate and the dollar amount of losses;
2. Mismanagement by Agency employees;
3. Business failures in minority areas;
4. Recoveries following defaults;
5. SBA record keeping;
6. The mission of the program.

In each area, the results of a statistical analysis commissioned by the Globe-Democrat were presented in combination with case studies and interviews with the borrowers and agency personnel. The Committee's review of this program essentially confirmed the statistics and conclusions presented in this series.

### *Response of SBA*

To some degree, the problems which were pervasive in the direct lending programs have been overcome with the enactment of the Reconciliation Act of 1981. This legislation reduced funding for direct lending programs by 40 percent, increased the interest rates on direct loans and established uniform credit terms which toughened the criteria necessary for approval of loans. These statutory changes which reduced the amount of funds available to small business, essentially forced SBA to exercise greater care in approving direct loans. The pressure to "get the money on the street," which had previously been the motivating factor in many of the loans made under this program was effectively removed. SBA Administrator Michael Cardenas implemented a new policy which "emphasized the quality of loans versus quantity of loans." Mr. Cardenas also stated that the Agency revised its internal operating procedure by:

1. Abolishing all numerical goals in loan making activities;
2. Measuring loan-making personnel on their ability to improve their loan decisions and loan processing;
3. Implemented a comprehensive debt collection plan;
4. Revising regional and district operating plans to reflect this renewed commitment to making quality loans.

Mr. Cardenas emphasized that the Agency did not intend to abandon its role of acting as a lender of last resort. However, he did indicate that SBA intended to carefully review all future loan applications to ensure that the small amount of funds allocated to the direct lending programs were used where they might provide some lasting benefit to a small businessman and to the community rather than simply providing everyone with an opportunity to fail.

### *5. SBA surety bond program*

On June 30 and September 25, 1980 and on March 11, 1982, the Committee conducted hearings on the SBA Surety Bond Guarantee Program (SBGP). The hearings resulted from an extensive investigation of the program by Committee staff. The investigation found a program in disarray, highly vulnerable to fraud, inconsistently managed and wasteful to Federal funds.

The hearings demonstrated that SBA relies on private surety companies to monitor the underwriting and claims processing connected to surety bonding, but lacked sufficient controls over these companies to ensure compliance with Federal laws and regulations.

The Committee heard testimony from the SBA Inspector General (IG) that two organized crime figures in Chicago had infiltrated and taken advantage of the program. In one case, an organized crime associate who owned a bonding agency which represented one of the largest surety firms in the program, used an interlocking web of concealed business relationships to turn contracts into defaults and bond losses into financial windfalls for himself and his associates.

In a separate case, another organized crime associate used a straw corporation to bilk SBA and two large sureties through false bidding and fraudulent charges for supplies.

The Committee also found that certain large surety companies were experiencing high loss ratios due to poor underwriting or deficient claims adjusting. Many surety firms experienced lower, acceptable loss ratios, but SBA has made no attempts to weed out the companies that may have been costing the Treasury millions of dollars unnecessarily.

One of the more troubling aspects of the investigation is that the Committee was forced to conduct a second comprehensive examination of the program in 1981 and 1982 after discovering that SBA had taken a business-as-usual approach to the SBGP in response to the 1980 hearings.

In addition, the Department of Treasury, which has the responsibility to certify surety companies for participation in Federal bonding activities, took no corrective action in response to the Committee's finding that one major surety had a 48 percent ownership comprised of associates or of individuals connected to organized crime.

In response to the Committee's 1982 hearing, SBA took initial steps to buttress personnel and add a professional claims adjuster on a consulting basis to improve management of the SBGP.

#### *Background*

From 1965 until 1970, Congressional hearings were held to examine the problems small contractors had in obtaining bonds. The overwhelming finding of these hearings was that small contractors were prevented from obtaining business because they were unable to secure bonds from private insurance companies.

Congress first provided for surety bond guarantees in the Housing and Urban Development Act of 1970 to alleviate bonding difficulties afflicting the small contractor. The intent of this provision was to assist the small contractor in developing to the point that the firm could secure bonds without a Federal guarantee.

Under the Small Business Investment Act, SBA is authorized to provide surety bond guarantees of up to 90 percent of incurred losses resulting from a breach of the terms of the bond. Originally, guaranteed bonds were limited to contracts with a maximum value of $500,000. Public Law 93-386, enacted in August 1974, raised the contract limit to $1 million.

The SBGP began operating in 1971, guaranteeing contract bonds for small construction, service, and supply firms. Since then, SBA has guaranteed bonds on more than 110,000 contracts worth approximately $7.9 billion. More than $1.6 billion in contracts were guaranteed during Fiscal Year 1978 alone. SBA reported a program cost of about $98.4 million through April 1979. Approximately 6775 defaults had occurred in the program since its inception.

Surety bonding is often a prerequisite, especially for construction work, to the award of both Government and private contracts. The Miller Act, for example, requires surety bonds on all Federal construction contracts of $25,000 or more. Many state and local governments have adopted their own versions of the Miller Act, as well.

The surety bonding relationship is a three-party arrangement in which the surety company, for a fee, assumes the financial obligations which the contractor owes the vendor. When the obligated surety incurs a loss, it can sue the contractor to receive its loss. In the event of a default, the surety takes over the contractor's right to payments from the vendor.

Although surety is listed as a line of insurance in most state insurance statutes, the concept of surety is much different from insurance. Placing a surety bond is more like approving a loan than writing an insurance policy. After examining the finances of a contractor, the surety agent, much like a bank loan officer, must determine whether the company's credit record indicates it will meet its obligation. If the determination is favorable, than the surety company will issue a bond for a fee. Under the SBA program, the contractor pays the surety company a performance and payment bond premium. The surety company pays SBA 20 percent of this premium.

Where bonding is required, the contractor usually must obtain all three types of bonds guaranteed by SBA: bid bonds; payment bonds; and performance bonds. While the payment and performance bonds describe separate obligations, they usually are combined in one transaction, so that one premium covers both. Each is described below:

> A bid bond must be presented with a bid on a proposed contract, when required. It is a guarantee by the bidder and the surety company that, if a bid is accepted by the vendor, the bidder will provide performance and payment bonds and perform the work in accordance with the vendor's specifications for the bid amount.
>
> A performance bond is a guarantee by the contractor and the surety company that the contractor will perform the con-

tract in accordance with plans, specifications, and all other contract documents.

A payment bond is a guarantee by the contractor and surety company that the contractor will pay promptly the wages of all employees of the contractor working on the specific job; the invoices for all materials used by the contractor on the job; the invoices for all subcontractors; and all other direct jobs costs.

There are two types of surety companies: the standard company and the specialty company. Standard companies write surety bonds as a normal part of their insurance business. They have, for the most part, not participated in the SBA guarantee program because bonds for small contractors are too small to be profitable. The SBA program created a second type of surety firm. It has become known as the specialty surety company because its primary activity and source of income stems from writing SBA-guaranteed bonds. These companies write 93 percent of SBA bonds and would not exist but for the program.

The problems uncovered by the Committee investigation revolve around the operation of the specialty companies. The General Accounting Office (GAO) estimates that specialty surety company loss rates exceed those of the standard companies by 30 percent.

Specialty companies operate at a higher cost to SBA because they usually have no internal claims departments and frequently charge the agency for up to 90 percent of expenses incurred from adjusting claims. These costs include expenses for attorneys, claims managers and examiners, and other administrative personnel. Standard companies, on the other hand, have their own internal claims departments and do not charge SBA for the costs of claims processing.

GAO noted that SBA lacks a systematic method to verify claims submitted by specialty companies. The agency rarely questions specialty company claims processing expenses.

Moreover, since the agent who writes the surety bond for the specialty company often handles the claim (for which he is paid an additional substantial fee) through affiliated claims adjusting firms, there seems to be little incentive on the agent's part to prevent defaults.

SBA does not directly bond a contractor. Small contractors in need of a surety bond contact the local agent of a surety company. The contractor provides the agent with various background, credit, and financial information required by the surety company. The agent supplies the surety company with the information and the surety company decides whether to execute the bond with SBA's guarantee. This process is called underwriting. General agents for the specialty surety companies have the power of attorney to make underwriting decisions without first consulting the surety company.

If the surety approves the bond, it submits the contractor's application to SBA along with underwriting information which includes the applicant's experience and financial position. SBA makes the final decision to approve or reject the bond guarantee.

SBA can approve a bond guarantee only if the following conditions are met:

The party seeking the bond is a small business concern (annual receipts of $3.5 million or less in the construction business).

The bond is required in order for the party to bid on or perform the contract.

The bond is not otherwise obtainable under reasonable terms and conditions from the private market.

The applicant can reasonably be expected to perform as required by the contract.

The contract meets requirements established by SBA for feasibility of successful completion and reasonableness of cost.

The terms and conditions of the bond are reasonable in light of the risk involved and the extent of the surety's participation.

In the event of a default by the contractor, the surety company is obligated to complete the contract. All default claims are processed through SBA's Central Office. The SBA Guarantee Agreement specifies that the surety shall take charge of all claims matters arising under the bonds; determine its liability; compromise, settle or defend any claim or suit; and take such action as it deems necessary to minimize loss. The surety has the right to recover any losses it sustains from the contractor. In addition, SBA must reimburse the surety 80 to 90 percent of its unrecovered losses.

### *Scope of investigation*

In August 1978, the Committee asked GAO to conduct a review of the Surety Bond Guarantee Program. GAO furnished a final version of its report to the Committee on December 27, 1979. The report found serious flaws and abuses in the program, which was subsequently confirmed in two 1980 hearings by the Committee.

In October 1981, Committee staff made a preliminary inquiry at SBA to learn if the agency had paid certain claims submitted by International Fidelity Insurance Company of New Jersey (IFI) on bonds written by the American Bonding Agency, a firm once controlled by a known associate of organized crime. Staff learned that, although the claims had not been paid, SBA had not conducted audits or investigations of the claims, that they were still a pending matter, and SBA could eventually be forced to pay the surety for the losses incurred.

In the course of reviewing these specific claims, Committee staff discovered that the program had not improved since the 1980 hearings, and that apparently, SBA continued to be defrauded. The initial review led the Committee into a full-scale follow-up investigation of the SBGP.

The follow-up review took a broader look at the program. The Committee worked closely with the SBA IG in 1981 and 1982, as it had done in 1980. As a result of the hearing, the IG had conducted random audits of 14 claims. Five of the audits noted serious deficiencies, and three of the audits were referred to the Department of Justice due to findings of alleged criminal fraud.

The IG had also audited the claims operation of American Fidelity Fire Insurance Company of New York (AFF), which at the time of the 1982 hearing, was the largest participant in the SBGP since the program's inception. The audits of AFF were critical of the firm's claims handling and underwriting.

The Committee also had access to the examinations of AFF by the New York Department of Insurance and a separate investigation of AFF's former managing agency, Market Insurance Corporation of California, by the California Department of Insurance. The Committee became concerned about AFF due largely to the findings of the IG and the respective state insurance departments.

Committee staff took field trips to interview principal officers of AFF and Market in New York and California. The Committee was assisted while in California by staff of the California Department of Insurance and the State's Department of Justice, who provided background information on Market.

As part of the review, Committee staff also interviewed numerous individuals connected to the surety industry in order to learn more about the problems they were experiencing in the SBGP.

### *Findings*

The Committee's review identified concerns in four main areas: underwriting; loss minimization; graduation; and management assistance, which are discussed below:

> SBA approves most surety bond guarantee applications based on incomplete or erroneous underwriting data supplied by surety agents. Of 639 applications examined by GAO, 87 percent contained unreliable information. SBA normally relies on the information supplied by the agents and does not take steps to independently verify the data. Despite these serious underwriting deficiencies, SBA has approved 96 percent of the bond applications it received since the program began. Henry Eschwege, Director of the Community and Economic Development Division, GAO, testified before the Committee that one surety agent, for example, reported that a contractor had working capital of $164,000 when, in fact, an examination of the contractors' financial statements showed a negative working capital of $43,000. In another case, an agent reported working capital of $105,000 for a contractor, when the actual amount was only $3,000. The agent reported this information on seven different bond applications and SBA approved bonds totaling nearly $1.4 million. The contractor ultimately defaulted on 13 contracts covered with bond guarantees.
>
> SBA and the participating surety companies are not making an effort to minimize losses by attempting to prevent contractor defaults. Although standard sureties monitor bonded contracts to determine progress or susceptibility to default, specialty sureties do not. GAO found specialty surety loss rates to be 30 percent more than those of standard companies. Specialty sureties write 93 percent of the bonds for the SBA surety program. Also SBA does not attempt to monitor contractor performance.
>
> Although one premise of the program is to assist small contractors in developing the ability to secure private bonds, the Surety Bond Guarantee Program is not significantly graduating contractors into the private bonding market. Only about 6 percent of 123 contractors in the program reviewed by GAO

had graduated. In fact, several contractors currently participating in the program probably qualify for the private bonding market. SBA has no procedures to determine graduation. Furthermore, the specialty surety companies have no incentive to encourage contractor graduation. If a contractor graduates, the specialty surety will lose a client to the private market.

SBA does not provide management assistance to contractors in the program. The agency relies on the contractor or surety agent to request management assistance. When GAO reviewed 273 randomly selected contractors, it found only five instances in which management assistance was requested. Management assistance could prevent defaults, but contractors appear reluctant to request it because they either feel SBA's management assistance is inadequate or that their company's managerial capability is sufficient.

### *6. SBA, SBIC and MESBIC programs*

#### *Summary*

The Committee conducted an oversight hearing on the SBA's Small Business Investment Company (SBIC) and Minority Enterprise Small Business Investment Company (MESBIC) programs on December 16, 1982. The hearing examined the nature of regulatory and possible criminal violations committed by some program participants. As part of the investigation, two companies were selected as case examples of the more egregious types of fraud and their officers were subpoenaed to testify.

SBA Administrator James Sanders testified at the hearing and outlined the substantial benefits of the program to the economy. The Administrator noted that the programs have been highly successful in terms of creating jobs and providing needed venture capital to the small business community. However, he also recognized some of the problems of the SBIC and MESBIC programs and outlined the agency's proposed regulatory and management reforms designed to eliminate abuse of Federal dollars.

The acting Inspector General (IG) of SBA testified that management of the program had recently improved; however, he expressed concern over the number of regulatory violations that his auditors continue to find during annual examinations. He assured the Committee that the program was "not rampant with fraud" and that the companies under investigation for alleged criminal activity represented a very small portion of the program's participants.

Representatives of the National Association of Small Business Investment Companies (NASBIC) and the American Association of Minority Enterprise Small Business Investment Companies (AAMESBIC) agreed there were some problem companies participating in the program, but contended that the frequency of violations cited by the Office of Inspector General was overblown, and companies which took advantage of the programs were limited to only a few.

As a result of the hearing, Chairman Weicker requested that one of the case studies—First Capital Corporation of Ft. Worth, Texas—be investigated further by the Office of Inspector General for possible rereferral to the Department of Justice. A second case, involving the President of the Feyca Investment Company of Coral Gables, Florida, is due to be further studied at a Committee hearing scheduled for February 3, 1983. Felipe De Diego, the company's president, indicated during the December 16, 1982, hearing that he would invoke the Fifth Amendment in response to certain questions pertaining to his use of company funds. His attorney requested more time to study his client's case, and agreed to return with De Diego on February 3, 1983.

### *Background on the SBIC and MESBIC programs*

The SBIC program was authorized by the Small Business Investment Act of 1958 (15 U.S.C. 661 et seq.) to stimulate and supplement the flow of private equity capital and long-term loans to small businesses for growth, expansion and modernization.

Congress approved the Small Business Investment Act to correct an "institutional gap" in the economic structure of the U.S. that made it difficult for small businesses to obtain equity capital and long-term credit. Congress declared that the Act's purpose was to: ". . . improve and stimulate the national economy in general and the small business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply . . ." The Act authorized the creation of SBICs and MESBICs, regulated and licensed by the SBA, to achieve the goals of the law.

SBICs and MESBICs are SBA-licensed companies which, through a private and public sector partnership, provide equity capital, long-term loans and management assistance to small business concerns and to small business concerns owned by socially or economically disadvantaged persons.

In return for a commitment to invest in small businesses, SBICs are licensed by SBA and authorized to issue a debenture, which is guaranteed by the Federal Government at the full cost of money to the Treasury, plus a premium; MESBICs, which go through the same licensing procedure, obtain leverage capital from the government through the purchases of preferred securities in the MESBIC itself and through debentures. To be currently licensed as an SBIC or MESBIC, the company must first have a minimum of $500,000 in private sector, paid-in capital. Before an SBIC can leverage any funds, it must have first committed at least 60 percent of its own capital to investments in small business concerns.

The responsibility for licensing and regulating SBICs rests with the SBA Investment Division, under the direction of the Associate Administrator for Finance and Investment and the Deputy Associate Administrator for Investment. As part of its administration of the program, the Investment Division authorizes direct or guaranteed government financing of SBIC licensees. The Investment Division is also responsible for determining violations of, and enforcing compliance with, the Small Business Investment Act or SBA regulations.

As of March 31, 1982, SBICs had more than $1.1 billion in outstanding loans owed to SBA and had made more than $4.4 billion in financing to small businesses since the inception of the program.

*Findings*

The SBA Office of Inspector General is currently required by law to conduct annual examinations of each SBIC, determine regulatory or criminal violations and recommend remedial actions for violations. If an allegation or criminal activity exists, the case is referred to the Department of Justice. In all other cases, the examinations and recommendations are referred to the Investment Division, which has sole responsibility for enforcing compliance of regulations and statutes.

Based on examination experience with more than 1,100 licensed SBICs since 1958, the IG issued a study—"Report on a Special Survey of the Small Business Investment Company Program"—in February 1980. The survey specifically covered 1,016 reports of examination over a three-year period from July 1976 to June 1979. The survey "developed a profile of the findings of statutory or regulatory violations reported by our auditors, with particular reference to significant violations of SBA Rules and Regulations."

As of August 31, 1979, when the survey's statistical analysis was completed, there were 413 licensed, operating SBICs in the program. The special report concluded that 42 percent of these companies were cited for "significant violations" of regulations. Raymond Randolph, the Acting Inspector General testified at the Committee's December 16 hearing that the violation rate is consistent, and was 41 percent during the latest examination cycle. Randolph deemed significant violations to be non-adherence to one of six regulations—the so-called "significant six"—briefly summarized as follows:

*Cost of Money:* SBICs cannot realize returns in excess of 6⅞ percent over their cost of money from the FFB on funds invested in small business (13 CFR 107.301(c)).

*Overline:* An SBIC cannot invest more than 20 percent (30 percent for MESBICs) of its paid-in capital and paid-in surplus in any single small business and its affiliated concerns (13 CFR 107.301(d)).

*Prohibited Investments:* Certain types of financings are prohibited by the regulations. These include real estate speculation or rental transactions, purchases of goods from suppliers associated with the SBIC, certain relending or reinvestment activities, foreign investments, stock purchases or other capital investments in the SBIC and use of funds to discharge a debt incurred by the SBIC (13 CFR 107.1001).

*Conflicts of Interest:* The regulations prohibit all forms of conflicts of interest involving self-dealing prejudicial to a small concern, the licensee, its shareholders or partners, or to SBA. For example, a licensee cannot invest in a company controlled by a director of the licensee (13 CFR 107.1004).

*Control of Portfolio Concerns:* SBICs and their associates cannot control a portfolio concern, except to protect their investments, and then only when a divestiture plan is approved by SBA (13 CFR 107.902).

*Activities not Contemplated by the Act:* Certain activities not contemplated by the Small Business Investment Act are also prohibited. For example, an SBIC cannot invest in a large business or certain types of firms such as pornographic enterprises (13 CFR 107.803).

Randolph told the Committee that:

> The Office of Inspector General turned its attention to this persistent rate of findings in 1980 when we issued the Special Survey Report of the SBIC Program. In that survey, we explained the actions taken by program officials in the Investment Division to effect corrective action by the licensee. What we found at that time was an institutional pattern of waivers of violations and some systemic causes. I can report that the conditions described in the Survey have improved.
>
> Communication between the Office of Inspector General and the Investment Division is greatly improved and the decision has recently been made by SBA to reconstitute the practice of sending cases of violators to hearing examiners where judicially enforceable orders and agreements can be obtained.
>
> In addition, the Office of Inspector General participated in the revision of the regulations for this program and the Investment Division was responsive to a number of our recommendations and concerns.
>
> It is too soon to tell whether or not these changes will have an effect on reducing the rate of findings.

It should be noted that while all violations identified by the IG in the report fall into the "significant six" category, some were substantially more serious than others. For example, even if the interest rate charged by an SBIC exceeded the allowable rate by .01 percent, this was a "significant six" violation; however, such a mistake would not in itself call into question the overall operating practices of the licensee. For the period between January 1981 and April 1982, Committee staff reviewed 303 reports of examination which contained "significant six" violations or other regulatory violations which the IG considered serious. It appeared that in 112 of the reports, although they contained violations of one of the "significant six" regulations which required corrective action, the violations themselves did not appear to be of the kind that threatened the operation of the small business concern receiving the assistance or called into question the overall operating business practices of the SBIC. The remaining 191 reports, however, contained significant violations which appeared serious and to require immediate action.

These reports came from a universe of 624 examinations. So, for the period reviewed by staff, 30 percent of the examination reports contained what appeared to be serious regulatory violations. This excludes those reports referred for investigation due to possible criminal violations.

In preparation for the hearing, the Committee asked the IG to update certain statistics pertaining to examination findings. The IG reported that for the period of March 31, 1981 to September 30, 1982, 44 percent of the 913 examination reports showed significant findings of regulatory violations. Of the 913 reports, 20 percent contained audit recommendations, indicating that the violation was serious enough to warrant a denial of funding to the licensee, liquidation or a request for surrender of license. Moreover, of the 181 reports which contain audit recommendations, 20 percent involved repeat violators.

In October 1981, the IG issued a Management Advisory Report (MAR) on idle funds and inactivity in the SBIC program. The MAR concluded that certain SBICs are inactive—not investing in small businesses—and have a combination of Federal and private funds in idle investments unrelated to the program mandate of assisting small businesses. Based on a "snapshot" of idle funds as reported by licensees to SBA, the IG found $321 million in idle funds, and projected that the total volume of idle funds may amount to $500 million (the $321 million figure came from 345 reporting SBICs, which only represent a portion of all licensees). The MAR recommended that SBA establish a line of credit for SBICs, which could only be drawn on when a financing is imminent. The IG also recommended strengthening the inactivity regulation (13 CFR 1003) to require an affirmative showing by SBICs that they are active. A regulation pending at OMB would require SBICs which are inactive to become active within 18 months.

Randolph testified that, "the purpose of this report was to focus the SBA's attention to the large amount of program money lying idle in the hands of SBIC's and not invested in small businesses. We did identify two principal causes; i.e., ineffective regulation and relative ease of obtaining government funds. Action taken to establish need for funding and action planned to monitor idle funds, including revised regulations, should reduce this problem."

The MAR, however, became quite controversial. Neither the SBA's Investment Division or the national associations that represent SBICs and MESBICs agree that a serious idle funds problem exists. They claim that idle funds are explainable and can often be attributed to a recent realization of profits from a venture capital investment which have not yet been reinvested. Furthermore, they strongly disagree with, and oppose, the line of credit recommendation. Investment Division officials claim that the line of credit recommendation would impose and require an extremely burdensome paperwork system and the associations contend that SBICs could lose investment opportunities due the time required to draw on the line of credit.

No one is certain of the cause of idle funds or the significance of idle funds as a problem. Although inactivity is a violation of the regulations, and idle funds is a possible sign of inactivity, idle funds are not a per se violation of the regulations. The $321 million figure is an accurate moment-in-time picture of SBIC captial lying dormant in certificates of deposit and other such investments. However, how much of that amount is an unpardonable use of capital is unclear.

A special, three-member task force of SBA officials examined the MAR and responded to it. The task force, in a memorandum to Deputy Administrator Donald Templeman, concluded that: ". . . it is our view that a pervasive or serious excess idle funds problem does not exist. However, we recognized that there are a limited number of leveraged SBICs which have excess idle funds due to inactivity." The memorandum further concluded that "we agree with the MAR's finding that SBA does not now have the regulatory and enforcement tools necessary to force them to become active or in the alternative, force return of the leverage and/or remove inactive SBICs from the program."

Although the task force agreed that a strengthened inactivity regulation is necessary, it disagreed with the "MAR's conclusion that, coupled with inactivity, excessive leverage is to blame for excess idle funds. Analysis of the data on which the MAR's findings are based shows that excess idle funds are instead associated with a lower level of leverage. Thus, we do not support the MAR's recommendation that the leveraging procedures be changed to provide for the leveraging of SBIC's on an incremental basis." In other words, the task force concluded that idle funds was a more prevalent problem in SBICs that had received the lesser amounts of government leveraged funds.

The IG examinations also detect situations which appear to violate Federal criminal law and which require more than administrative action. When this occurs, the cases are referred to the Investigations Division of the Office of Inspector General for further investigations. Randolph provided several examples to the Committee of criminal schemes. For example, in one case, he testified:

> A corporation obtained an SBIC license without any initial capital investment on the basis of representations made by the principal and others. The SBIC received $1,000,000 in leveraged funds, a substantial portion of which the principal converted to his own use or benefit.
>
> Specifically, he used $250,000 to purchase a luxury yacht, deposited $82,000 to his personal checking account and purchased a personal Certificate of Deposit for $200,000. The principal also made personal loans of $70,000 to friends and repaid a delinquent bank loan of $19,000 for a company owned and controlled by the principal. Through the device of a "phony financing", the principal diverted $75,000 for the down payment on a personal residence. The principal pled guilty on charges of mail fraud and false statements and was sentenced to three years imprisonment plus five years probation to be served consecutively. He was also required to make restitution to SBA in the amount of $1,000,000.

In another case, Randolph said:

> The SBA provided $1,000,000 in financing to an SBIC after the principals represented that they had instead $500,000. An investigation disclosed, however, that no private paid-in capital was invested. The principals used the Agency money for their own benefit and the benefit of other members of their family. The case was presented to a grand jury after an investigation of the corporation by the U.S. Attorney's office and SBA. The principal entered a guilty plea to three counts of defrauding the government and received the following sentence:

A $1,000 fine;
Requirement to repay $1,000,000 to the Agency;
3 months in jail; and
5 years on probation.

The IG also noted weaknesses in the screening procedures used to license SBICs and MESBICs. Randolph described one startling case where a "licensee received a license after falsely representing to SBA that it had $1,000,000 in private funding available for investment. The examination and investigation prior to providing $1,000,000 in government funding disclosed that the principal of the licensee had a notorious international reputation and was known by several aliases."

Randolph stated this individual "is presently wanted for questioning in connection with fraud and check kiting schemes in two European countries, was convicted and sentenced in Paris, France, on worthless check charges in 1967, and is now under investigation by authorities of another European country for worthless check schemes. In the United States he provided information to a state licensing authority to the effect that he had $1,000,000 on deposit in a bank; the claim proved to be false."

Committee staff conducted an in-depth investigation of IG findings concerning a MESBIC in Florida, the Feyca Investment Company. Staff found that Feyca was licensed as a MESBIC by SBA on August 30, 1979. The company has received $1.5 million in Federal Government funding in the form of purchases of debentures and preferred stock.

In November 1982, the Office of Inspector General, SBA issued a special report pertaining to the use of company funds for personal expenditures by Felipe De Diego, President of Feyca. The report concluded that, ". . . amounts classified as advances or loans to officer in the records of Feyca Investment Company were mostly personal expenditures on behalf of Felipe De Diego, members of his family, his business associates and other persons and had no relationship to the licensee's legitimate business activity. The expenditures were in payment for personal travel, entertainment and personal obligations and items."

The special report identified a minimum of $132,000 in personal expenditures charged to the company, including yacht expenses, travel across the country and to South America, memberships in clubs, restaurant and nightclub checks, political contributions and expensive automobiles.

The report states that De Diego was once a member of a special unit of the Nixon Administration known as the "Plumbers." This unit was responsible for the Watergate break-in at the Democratic national headquarters. De Diego has admitted breaking into the headquarters on two occasions.

De Diego was indicted on March 7, 1974, for conspiring to violate the civil rights of Dr. Lewis Fielding. Fielding was the psychiatrist of Daniel Ellsberg, who leaked to the press the "Pentagon Papers," which relate to the Vietnam War. De Diego and others made an illegal entry into Fielding's office, apparently to obtain incriminating information on Ellsberg. The indictment was subsequently dismissed because it was purportedly based on testimony De Diego provided while under a grant of immunity.

De Diego's Watergate background is mentioned because Feyca provided loans totaling more than $200,000 to Frank Sturgis and Virgilio Gonzalez, who were also members of the "Plumbers" Unit. The report states:

> The questions which these two loans to start-up businesses raise are whether these are arms-length transactions . . .

De Diego was subpoenaed to testify before the Committee. In response to an initial question from Chairman Weicker regarding the findings of the special audit, De Diego denied that he had used company funds for personal expenditures. After a short break in the hearing, De Diego's attorney, Dana Brigham, informed the Chairman that his client would invoke his Fifth Amendment rights not to incriminate himself in response to Committee questions, and would not answer certain questions.

Brigham also stated that he needed more time to examine De Diego's case, and the Chairman agreed to provide the necessary time, requesting that De Diego return to testify before the Committee on February 3, 1983.

A second case investigated by the Committee involved the First Capital Corporation (FCC) of Ft. Worth, Texas, which was licensed by SBA as an SBIC on September 20, 1960. The company was purchased by John R. Payne and Harry S. Scaling on May 6, 1975 and moved from Waco to Ft. Forth. After the change in ownership, First Capital Corporation received $3.725 million in Federal Government funding in the form of debenture purchases.

On June 29, 1981, the Office of Inspector General (IG) of SBA, issued an investigation report in which it found that FCC had used a capital manipulation scheme involving the use of circular financings to make it appear that its private capital was much higher than was actually the case. The report concluded that, "Principals of First Capital and the principals of some small business concerns, conspired to defraud the Government through misapplication of funds and by submitting false statements in order to receive additional funds."

Since SBICs receive debenture funding from the Federal Government based on a formula relative to the company's private capital, FCC was able to apply for and increase its leverage funds from the Government by fictitiously increasing the amount of its private capital, according to the report. Between 1975 and 1980, FCC represented to SBA private capital, including increases, totaling $1.03 million, allowing FCC to receive total debenture funding of $3.725 million. The IG's investigation found that at least $390,000 of FCC's private capital "increases" were obtained through circular financing schemes which used the company's original capital, permitting FCC to obtain over $1.5 million of its Government leverage fraudulently through sham business transactions. For example, in one case, First Capital purportedly loaned $225,000 to a qualified small business. Within two days, the business owner reissued the funds to Scaling, who returned them to the account of First Capital, where the money was listed by FCC as increased capital; in fact, there was no loan (which under SBA regulations must be for a minimum of 5 years for SBICs) but simply a circular financing scheme to make FCC's private capital appear to have increased.

In December 1980, after SBA commenced its investigation, Payne and Scaling returned all money owed to the Government and attempted to immediately surrender its SBIC license. Ironically, because the funds were returned early, The Federal Financing Bank gave Panye and Scaling a $700,000 discount.

The IG referred the case to the Department of Justice for review. The U.S. Attorney for the Northern District of Texas subsequently issued a declination to prosecute, citing the fact that although the case resulted in a "fraud being uncovered", since there was no loss to the Government because Payne and Scaling had returned all of its Government funds, and the Government could therefore show "no harm", and since the case was a complex one, even a successful prosecution would not result in any substantial punishment being handed out. The U.S. Attorney also noted that, although prosecution had been declined, he felt, ". . . there is a certain deterrent effect to individuals such as Mr. Payne and Scaling simply by knowing that they were 'caught' and that they will be much less likely to engage in such 'free-wheeling' and dealing with Government money in the future."

Payne and Scaling were subpoenaed to testify before the Committee. They denied the findings of the IG's investigation, insisting they had made legitimate business transactions.

Chairman Weicker stated he found their explanations "Unsatisfactory," and asked the IG to conduct a comprehensive investigation of all First Capital business dealings in coordination with the Department of Justice.

### *SBA testimony*

James C. Sanders, Administrator of SBA, testified at the December 16 hearings. He noted that it is beyond doubt,

> . . . that this innovative program has succeeded in providing unique and much needed assistance to small businesses. Since its inception, nearly $4.5 billion of financial assistance has been provided to more than 66,000 small concerns which in turn have produced jobs, economic gains, and tax revenues far exceeding the government's cost of operating the program. In calendar year 1984, 2,329 small businesses received $387.1 million of disbursements from SBICs.

Sanders further stated that,

> . . . the benefits of this program are impressive. They extend to workers, stockholders, customers, suppliers, and to society at large. Venture capital success stories on individual "winners" in which SBICs participated are many. Companies such as Cray Research, Intel Inc., Federal Express, and Four-Phase Systems, are prime examples. From a broader perspective, the results are creation and maintenance of employment, improvement of productivity, introduction of new products and processes into our economic

stream, and most importantly perpetuation and reinforcement of entrepreneurial opportunity in the small business sector.

SBA, for the purpose of evaluation of the program, tracked several probability samples of small business recipients of SBIC financing through their life cycle in the SBIC portfolio. It found substantial improvements in the employment, sales, profits, and assets of these client firms. A sample of 100 small portfolio companies taken in 1973 showed after tracking these firms for six years that they increased employment, after deducting the effects of the failed companies, by 1,866 jobs after those six years. These 100 firms received initial SBIC disbursements of $12.2 million and benefited from an estimated $40 million dollar years of SBIC financing.

Sanders noted that of greater importance, an institutional source of venture capital now exists in the financial community as the result of the government's willingness to create such a program and its perseverance in this program through the bad as well as the good times. He stated that the human capital that has been developed over the last 25 years in the SBIC program is not often recognized but is nonetheless significant, and that the expertise of the financial entrepreneurs that operate the SBICs is perhaps even more important to the nation than the other resources of the program.

In recognizing that problems do exist in this program, Sanders noted:

> The most serious matters reported to program officials by SBA's Inspector General usually involved deliberate misuse of funds, misrepresentations, and poor management by licensed small business investment companies. These problems, while not attributable to a major segment of the SBIC industry, cause us all great concern as do patterns of less serious violations which, while not criminal in nature, indicate a lack of responsibility on the part of some SBICs.

The Administrator testified that he was also concerned about the liquidation rate of SBICs and MESBICs. "As of September 30, 1982," he said, "liquidation action completed resulted in charge-offs on 116 cases for $32,953,000, out of $70,094,634 due to government." Sanders said there were an additional 117 active liquidation cases in which the principal balance due SBA totaled more than $150 million.

The Agency recognized the growing number of problems in the program in early 1981, and took several remedial actions. On April 17, 1981, SBA initiated a moratorium on new licensing of SBICs and MESBICs which lasted until August of that year.

On August 16, 1982, the Agency proposed a new set of regulations. Sanders testified that the new regulations would increase minimum capitalization from $500,000 to $1 million for new license applicants; strengthen the regulations on inactive companies; lengthen minimum financing terms for license investments in small businesses; encourage equity investments; and eliminate technical violations of regulations.

*Industry response*

Robert Zicarelli, Chairman of NASBIC testified before the Committee. He pointed out that, over the past 23 years, SBICs have invested more than $4 billion of equity capital and long-term venture loans in more than 60,000 small businesses. He said that there are "clear indications that in spite of uncertain economic conditions, hundreds of venture capitalists and entrepreneurs are willing to risk their money and reputations on the ability of innovative, well-managed small firms to grow and be profitiable."

Zicarelli also related to the Committee the findings of a study commissioned by NASBIC two years ago, in an effort to determine the impact of SBIC financing on small businesses. NASBIC commissioned the international accounting firm of Deloitte, Haskins & Sells and the economic consulting firm of Arthur D. Little, Inc., to do a data survey of SBIC portfolio companies. The survey, completed in early 1980, showed that SBIC-financed small firms experience growth rates almost 10 times as great as those of other small companies in such key areas as sales, profits, and employment. The study also showed that the growth of Federal tax payments of SBIC portfolio companies is over 5 times that of all other small concerns, and that the actual cost to the government of creating a job through the SBIC program is only $312.

In referring to the article of SBIC portfolio companies, Zicarelli stated:

> The figures from the economic impact studies are impressive; however, the results would be less important if the small concerns that the SBIC program was designed to promote did not value SBIC assistance. SBA's own surveys over a period of six years fully demonstrated that SBIC portfolio companies place a high level of value on SBIC assistance. The portfolio companies in SBA's surveys were selected on a statistically random samply basis and responses were given anonymously in order to assure the replies were credibile and unbiased. Over 95 percent of the entrepreneurs questioned said the SBIC investment was of significant importance to their firm's growth, and 90 percent gave clear evidence of their satisfaction with the SBIC relationship.

Zicarelli also noted in his testimony to the Committee that,

> . . . Deloitte, Haskins & Sells followed up their economic impact survey with a second study, designed to measure the direct cost to the Federal government of the SBIC program, and the benefits generated by SBIC activity. DH&S found that in 1979, Uncle Sam spent only $4 million to run the SBIC program—$2 million on administrative costs and $2 million to cover losses on loans to SBICs. In return for that $4 million. the Federal Government received a total of $440 million in increased tax payments from SBICs, their portfolio companies, and the employees of those portfolio companies—a cost/benefit ratio of 1 to 110. I have been unable to find any other government program that

> comes even close to generating such tremendous benefits at virtually no cost to the tax-payer.

In addressing abuses in the program, Zicarelli testified that the objective of NASBIC is to "completely eradicate all 'major' violations" of SBA regulations, and to "root out the few bad actors who may have slipped into the program."

Although Zicarelli admitted that "over the years a small number of out-and-out criminals, embezzlers or sleazy operators have been involved in the SBIC program . . . we know that the vast majority of SBIC managers are honest and reputable businessmen who are attempting to make a fair profit through legitimate business practices . . ."

NASBIC strongly disagrees with the number and frequency of regulatory violations cited by the IG. Zicarelli said, "Reporting gross numbers of 'alleged' violations may make good headlines, but they simply distort the real picture of how many serious violations actually take place." NASBIC contends that 80 percent of all SBICs have no major violations.

Patrick Burns, Legislative Chairman of AAMESBIC also testified. He reported that over the past five years, MESBICs have invested more than $136 million in small, disadvantaged businesses.

Burns agreed that the IG findings were overblown. He warned that the Inspector General "should be cautious in overstepping the boundaries of his authority" and should simply "decide whether the MESBIC's Board of Directors has used a reasonable process in revealing its conclusions." Burns went on to state that:

> As investors, MESBIC executives want to insure that the kinds of companies they invest in can achieve some degree of growth and offer a product or service that is beneficial to society. We want to be able to invest in companies whose operators are knowledgeable about good management practices. In addition, we prefer that our investees have a substantial stock in the success and liability of the company.
>
> When making investment decisions, we look at factors like the kind of money that will be necessary to make the company grow and assure stability, the financial and managerial responsibility we will have to accept, and the potential profitability of the company. The most essential factor, however, is people. We must examine the entrepreneurs' successes, and their failures, and they must be educated and trained.

### F. SMALL BUSINESS SIZE STANDARDS

The Small Business Act of 1953 broadly defines a small business as one which is independently owned and operated and not dominant in its field. The Act authorizes the Small Business Administration (SBA) to establish more specific, industry-related criteria that can be used to more accurately classify the many segments of the small business community in order to determine eligibility for Agency program benefits, procurement set-asides, regulatory exemptions and other forms of Federal assistance.

Currently, SBA uses a variety of measures for size determinations. For example, businesses in the retail, service, wholesale, construction, and agricultural industries, are measured by an annual receipts criteria (averaged over 3 years). Other industries such as manufacturing, research and development, and mining firms are measured by an employee number criterion.

On March 10, 1980, after a long internal review, the SBA announced its intention to significantly revise its method for determining small business size. The first notice of proposed rulemaking on size standards was offered in part to address GAO criticisms of the Agency's previous method of determining small business size, and in part to counter the small business community's growing dissatisfaction with the complex and confusing nature of the Agency's existing size standards.

However, the initial proposal to revise and simplify the size standards met with widespread criticism from affected small businesses and from Federal agencies. In fact, over 86 percent of the public comments received by the SBA were critical of the proposed regulatory changes to the existing size standards.

In September 1980, as Ranking Minority Member, Senator Weicker led the Committee in a move to impose a moratorium on any final changes in the existing size standards prior to March 31, 1981. The Committee, and later the Congress, adopted his recommendation in order to assure that all interested parties were allowed ample opportunity to comment on the SBA's newly-proposed business size definitions.

During the 97th Congress, the Committee has continued its analysis of proposed regulatory changes to the SBA size standards. Following the end of the moratorium, the Committee held a full day of hearings on March 5, 1981, to further consider the size standard revisions proposed by the SBA. The hearing, chaired by Senator Hatch, focused on broad policy questions concerning small business size definitions as well as on individual objections to specific parts of the proposal. The hearing record, which included testimony from more than a dozen small businesses, associations and other business organizations, was then submitted to the SBA Administrator and his staff for their analysis and review.

On May 3, 1982, the SBA issued its second advance notice of proposed size standard revisions, this proposal reflecting the public comments received on the first draft. The May 3 notice uses one criteria for measuring business size—number of employees—but retains the annual receipts criteria for measuring business size in agriculture and construction.

The May 3 notice also establishes a maximum employee limit above which a business would no longer be considered small by the SBA. In the manufacturing industry, for example, the proposed limit is 500 employees. This is a significant reduction from the 2,500 employee ceiling proposed in the 1980 notice.

The SBA is still in the process of reviewing the hundreds of comments received in response to the May 3, 1982 proposal. Members of the Small Business Committee have expressed concern over several sections of the current proposal (including revisions to the architect and engineering, and research and development size standards) and will continue to carefully oversee the SBA's regulatory initiatives on the size standards.

### G. SBA VETERANS ASSISTANCE

In 1973, Congress passed legislation, which later became Public Law 93-237, to direct the Small Business Administration (SBA), to give "special consideration" to veterans of the armed forces.

Over the years, this law has been the focus of Congressional hearings and numerous reports and studies. Full implementation of the law by SBA has been delayed due to the ambiguity associated with defining "special consideration".

However, during the latter part of the 97th Congress, both the SBA and the Small Business Committee made a concerted effort to reassess and redefine SBA veteran programs in accordance with P.L. 93-237.

In late 1981, the SBA, under a directive by Administrator James Sanders, formed a Veterans Task Force to specifically define by regulation, the term "special consideration", and to make recommendations on ways veterans would be given such consideration within Agency programs. Task force members, represented by various veterans organizations, government agencies, and SBA officials, conferred on ways to revamp existing programs, and consolidated their recommendations in a report which was submitted to the Administrator. As a result, Mr. Sanders issued an official policy statement in May, 1982 which addressed the subject of special consideration for veterans of the armed forces. Sanders directed the SBA to implement the following actions and policies:

1. There shall be established a permanent Office of Veterans Business Enterprise, within the Office of the Chief Counsel for Advocacy. This office shall be responsible for providing advice and counsel to SBA management on all legislative, regulatory, economic, and management policies affecting the interests of veteran entrepreneurs. Also, this office shall perform advocacy duties as defined in Public Law 94-305 on behalf of veterans, including the review of SBA programs and the activities of other government departments and agencies whose policies and regulations affect the interest of veterans in business.

2. New regulations as necessary shall be issued to clarify and assure that veterans are, in fact, provided "special consideration" within each assistance program of SBA. Associate and Assistant Administrators shall review their programs and activities and issue any required regulations or SOPs within 60 days from this date. Specifically, financial assistance regulations shall provide that qualified veterans receive higher priority in the processing and funding of loan applications, with particular attention to be given to the handicapped and Vietnam-era veteran. The "Pechin Study" commissioned by SBA in 1980, and the Report of the SBA-Veterans Task Force on Special Consideration for Veterans shall be used to guide the development of all these regulations.

3. Management assistance and business training for veterans shall be intensified over the next twelve months. In addition, special business training projects shall be intitiated in at least

five geographic locations convenient to reaching the maximum number of veterans. The skill and resources of the Small Business Development Centers, the Office of Public Information, and Agency procurement and technical assistance activities shall be employed in these projects. All other departments and activities of the Agency shall cooperate and lend support to this program as called upon.

4. Regional administrators and district directors are responsible for assuring the effective delivery of "special consideration" for veterans in all their operations and programs. Veterans Affairs officers (VAOs) shall be appointed in each regional and district office, if not alreeady designated. VAOs shall be highly qualified, trained, and experienced in SBA programs and procedures. These officers shall be readily accessible to veterans seeking agency assistance. Each program office shall monitor the performance of field offices in the effective delivery of services to veterans.

5. The Office of Administration, in cooperation with the Office of Veterans Business Enterprise and each program office, shall assure that information and data concerning the participation of veterans in all SBA programs are collected, measured, and analyzed in a manner which serves the policy making needs of the Congress and Agency management. The Chief Counsel for Advocacy shall periodically report to the SBA Management Board his findings and recommendations regarding veterans participation in SBA programs and the small business economic sector.

The Senate Small Business committee, which worked closely with the SBA Task Force and the agency on this issue, endorses this action by the Administrator and believes it to be a significant step forward for the veterans of this country. In a related move in September 1982, Senator Weicker, in his role as Chairman of the State, Justice, Commerce Subcommittee of the appropriations Committee, worked to appropriate $25 million to be made available for small business loans to disabled and Viet Nam veterans for FY 1983, in accordance with Public Law 97-72. That Committee earmarked an additional $3 million for use within the Office of Veterans Business Enterprise at the SBA in order to conduct management, procurement, and technical assistance programs for veterans. The provisions of the appropriations bill require that within 90 days of its enactment, the SBA report to the Committee on how the Office of Business Enterprise intends to spend its congressionally appropriated funds.

At that time, the Small Business Committee will evaluate the SBA's compliance with the provisions set forth on the SBA policy statement in accordance with Public Laws 93-237 and 97-72.

### H. THE SBA HOTLINE

In August 1981, the Department of Commrece established a toll-free telephone hotline to provide small business owners with answers to their questions about government rules and regulations. The Department's hotline was in operation for about 10 months. During that time, the hotline—the only such government/private sector communications systems in existence—received 5,000 calls from business men and women.

On June 2, 1982, however, the Department elected to shut down the hotline for budgetary reasons. Upon hearing this, Senator Weicker immediately called for the establishment of a hotline at the SBA. This hotline, Weicker said, "should be open to small business owners with all kinds of problems, not just those limited to regulatory affairs."

In a letter to SBA Administrator James Sanders, Weicker called the hotline "a vital link between the government and small business," and said, "small business owners do not always have the time, expertise or funds to seek solutions to problems through the Federal government, and unfortunately, have not been given significant input into the Federal decision-making process. This hotline would not only assist small businesses, but would provide policy-makers with a better awareness of the nature of day-to-day problems afflicting small firms."

Responding to the request from Senator Weicker, the SBA established its toll-free information system for small business on October 14, 1982. Known as the "Answer Desk", the SBA telephone lines are staffed by personnel from the SBA Office of Advocacy. From 8:30 a.m. to 6:00 p.m. Monday thru Friday, small business owners can call the Answer Desk and seek answers to all kinds of small business problems. If the SBA information specialists cannot answer a caller's question directly, he or she will be referred to the appropriate government office in Washington or around the country.

Currently, the Answer Desk handles approximately 350–400 calls a day. Calls have included inquiries about government contracts, regulations, possible sources of financing, pension plans and management assistance.

## CHAPTER THREE: SMALL BUSINESS AND INNOVATION

For years, the small businesses of this country have led the way in the discovery of new ideas, new products and new ways of doing things. Independent enterpreneurs—risk takers, by their very nature—consistently make inroads into areas of new technology and innovation that larger companies are sometimes reluctant or unwilling to explore. The result is that small businesses produce about 24 times the innovations as medium-sized and large firms do, and account for over half of all U.S. innovations. More importantly, because of their small size and comparatively low overhead, in most cases they can produce innovations at a substantially lower cost than large firms.

The Small Business Committee believes strongly that this tradition of small business innovation and invention should be commended and encouraged. To that end, it is important that small firms have access to capital and contracts to perform research, and that, when they make discoveries on their own, there is a mechanism in place that allows them to easily and economically patent and protect their inventions.

Through two new laws enacted this year, the Small Business Committee has sought to ensure that small firms can continue to lead the way in technology and innovation. At the same time, the American taxpayer will be assured of getting the most innovations for his tax dollar.

### A. THE SMALL BUSINESS INNOVATION DEVELOPMENT ACT OF 1981, S. 881

One of the major small business legislative victories won by small business during the 97th Congress was the enactment of the Small Business Innovation Development Act. The bill not only represents a major step forward for small business; it also addresses the steadily growing problem of declining American productivity.

This landmark piece of legislation, introduced in April of 1981, is designed to channel more Federal research and development funds to small business. In the July 22, 1982 Rose Garden bill-signing ceremony, President Reagan predicted the new law would "unleash" the "innovation and productivity of this nation's small businesses."

The bill required 10 Federal agencies—the Departments of Defense, Energy, Health and Human Services, Agriculture, Transportation, and Interior, as well as NASA, the National Science Foundation, the Environmental Protection Agency and the Nuclear Regulatory Commission—to set aside 1.25 percent of their annual R&D budgets for use by small business.

The legislation is being phased in over four years (with the exception of the Department of Defense, where there is a five-year phase-in). That process began on October 1, 1982. First year funding amounts to about $50 million. By FY 1987, the annual amount of R&D funds directed to small business under the legislation is expected to total $465 million.

Under the Act, the 10 affected agencies will be required to establish an SBIR program modeled after that of the highly successful National Science Foundation program. Small firms will be invited to submit research proposals to an agency concerning topics selected by each agency in accordance with its own R&D objectives. Those proposals which show the most scientific and technical merit and feasibility may be funded at a level not to exceed $50,000 for the initial development. Second-tier financing may be provided up to $500,000 for further research on those Phase I proposals that appear the most promising. Agencies are encouraged to conduct stringent peer reviews in the evaluation of all proposals.

In assessing Phase II proposals of approximately equal scientific and technical merit, agencies shall give special consideration to recipients of Phase I grants that have attracted private sector funding commitments to pursue commercial application of the research. This special consideration serves as a built-in incentive for participants in the program to seek ways to build upon the Federal research, thus fulfilling one of the bill's primary objectives.

At the bill-signing, the President called small business "a tonic for what ails this country," and said, "this bill recognizes the contributions of small, high technology firms to the nation's growth, productivity and competitiveness."

He added:

The Small Business Innovation Development Act recognizes that we in government must work in partnership with small business. Let me assure you of this Administration's strong commitment to this program. We will direct the result of the government to cooperate fully in speedily putting it in effect.

### *History of the legislation*

Over the past decade, the rate of productivity increase in the United States has been well below that of all leading industrial nations, most notably Japan and Germany. While this relative decline in our productivity stems from many factors, one of the chief causes has certainly been the slowdown in American innovation.

As other nations have been accelerating their research efforts, this country's Federal investment in research and development (R&D) in constant dollars, has remained virtually unchanged for the past decade.

At the same time, an increasing number of studies have shown small businesses to be the most efficient and fertile source of innovations. Despite that fact, only 3.5 to 4 percent of the Federal R&D budget has traditionally been spent with small firms. This underutilization of small businesses in Federal R&D is especially regrettable when the highly successful track record of small firms in generating jobs, tax revenue, and other economic and societal benefits is taken into consideration.

Based on studies of small business innovation, and on a series of Congressional hearings and executive agency reports issued during the past three years, the Committee concluded that one way to revitalize the U.S. economy would be to develop a means by which Federal agencies could better tap the innovative potential of small businesses.

The Small Business Innovation Research Act (the name was later changed to the Small Business Innovation Development Act), introduced on April 7, 1981 by Senators Rudman and Weicker, was designed to do just that. The purpose of the bill was twofold: to more effectively meet Federal R&D needs by the utilization of small innovative firms and to attract private capital to commercialize the results of the Federal research.

The Small Business Committee held five days of hearings on this legislation in 1981. The first hearing on May 13 in Washington, elicited the views of the past recipients of Research and Development awards from the National Science Foundation's SBIR program (the program after which S. 881 is modeled).

Stan Mason, President of Simco, Inc., of Connecticut, expressed these views:

> To make it in a large company, it helps to be tall and handsome and articulate. It helps to be conservative and not innovative. You must not take chances with the company's money.
>
> On the other, a man in the small company makes it on talent and not looks. He can share the results of his innovative nature in royalties and in shared ownership.

> However, I am not attacking large companies. They are the heart of the country's strength. They produce the wealth and the power that we are in America. And they are my customers.
>
> However, this is the crux of my testimony: If small companies produce the most innovative ideas and products and jobs for the nation, why not help them? This legislation (S. 881) is truly important to the future health of the country, both in the long and short term.
>
> The equation is very simple. If a dollar put toward supporting R&D for a large company produces X return for the country, that same dollar supporting R&D in small companies will produce X times 50 or 100. It is a good proposition and with very low risk.
>
> It seems to me it is a matter of priority. It is not that we want to give less emphasis to large corporate R&D. It is simply we want to recognize the potentiality of small company R&D. We want to be sure the money is used in the most productive way.

Dr. Orrie Friedman, of Collaborative Research, Inc. of Boston, testified:

> Based on our experience, it is my opinion that the SBIR program is an extremely important mechanism for stimulating innovation in small high technology firms. It provides financial resources otherwise generally unavailable to small companies with which to explore novel innovative ideas at the early conceptual stage when outside support is hardest to come by. Also, . . . such SBIR support may provide a mechanism that will stimulate the much desired and much sought for transfer to industry of imaginative new ideas from the academic community where the bulk of creative potentiality in this country still resides.

Dr. Lee Shevel, of the Whitehall Group of California, pointedly remarked: "A key question being addressed by this Committee is, Can any agency of significance not afford to take advantage of the innovation research capabilities of small business?"

On June 30, the Committee traveled to Boston, where members of the academic community, as well as small business owners, testified on the bill.

Dr. Arthur Obermayer, President of the Moleculon Research Corporation of Massachusetts, stated in a report:

> The Small Business Innovation Program is not just another government program, or another NSF program. It is unique in concept and execution and represents an experiment in itself. It is designed to be sensitive to the factors that motivate small, innovative companies toward product or process commercialization. This program is being considered by the Congress and other governmental agencies as a practical model for accelerating the innovation process in small businesses through government support.
>
> In order to appreciate its distinctive character, we must remember that technological innovation—or the commer-

> cialization of technology—is by its nature fundamentally a business function not normally carried out by government or universities. Government and universities can play a role in the innovation process, but unless they have a thorough understanding of how business is motivated and how it functions, their actions are doomed in failure.

He then concluded:

> This program could potentially be the most significant Government program of this country in the science and technology field.

A field hearing chaired by Senator Hayakawa, was also held in San Francisco on July 24. Mr. Michael Kieschnick of the Office of Economic Policy, Planning, and Research, State of California, told the Committee in reference to S. 881:

> There isn't any single policy which will increase innovation and spur the economy. It has to take place by reorientating thousands of private and public actions and attitudes. Tax policy is part of the picture.
>
> Changes in private management's attitudes toward long-term investment and risktaking are also a part of the solution. But the public sector must continue to play a role in R&D as well, and I'm convinced that the return on the publics investment will be higher if a larger proportion is allocated to small business.

Mr. Jack Wilson of the National Federation of Independent Business concluded his testimony with the following anecdote:

> The National Science Foundation has a very short modest program to support development of technological innovation by small firms. Without going into details, the competition for these awards is keen. The small number of winners are supported by NSF for a maximum of three years or until they are ready to market their product. But one very interesting thing occurs at the end of each competition. We are told a representative from the Japanese Embassy is always the first to arrive. He is interested in the winners—yes. However he is just as interested in the losers. Perhaps that should tell us something.

On July 15 and 16, the Committee heard the views of Federal agencies who would be affected by the legislation. Not surprisingly, the reaction was mixed, with several witnesses expressing reservations about the mandate of the bill. Some were concerned that the 1 percent set-aside proposed in the original version of the bill would jeopardize the quality of the Federal research. Dr. John A. DiBiaggio, president of the University of Connecticut, and spokesman for the Association of American Universities, argued that the set-aside would lead to funding decisions not based on the merits of proposals. A related concern was voiced by Henry G. Kirshenmann, Deputy Assistant Secretary for Grants and Procurement, Department of Health and Human Services. Mr. Kirshenmann objected on the grounds that the set-aside would force "a suboptimal allocation of resources." He also questioned the capability of the small business community to do the kind of research funded by HHS.

Senator Rudman, however, disagreed with claims that the legislation would threaten the quality of Federal R&D. He also took exception to the argument that small research firms were incapable of conducting the kind of research funded by Federal agencies. Moreover, he criticized the agencies' unwillingness to admit more small businesses into their R&D programs.

The following exchange took place between Senator Rudman and Dr. William F. Raub, Associate Director for Extramural Research and Training, National Institutes of Health:

> Senator RUDMAN. I want to just point out to you that you have excluded private companies from some of your basic research for a period of 10 years. That is correct; is it not?
>
> Dr. RAUB. More than 10 years.
>
> Senator RUDMAN. You are guilty of the biggest set-aside of all. We live in a capitalistic society and you penalize people who want to do research, and possibly make money on it, as though there is something wrong with that. I think it is the height of gracelessness for people paid with tax dollars and universities which receive tax dollars essentially to attack the very system which provides them with the dollars which fund their research and their salaries.

Others thought the 1 percent provision was too modest. Sherman Abrahamson, special assistant to the president of Control Data, told the committee that the figure should be closer to 20 percent. Congressman Berkley Bedell, Chairman of the Subcommittee on Energy, Environment and Safety Issues Affecting Small Business, of the House Small Business Committee, thought a 50 percent set-aside would be appropriate. Dr. Lee Shevel, National Science Foundation SBIR program winner and the former president of OMEX, a company specializing in information technology, viewed it this way:

> It could be argued that 1 percent is not large enough to make a difference. But when considering that small businesses with different motivations can achieve enormous gains in efficiency in the use of R&D funds as compared to a larger company, you could conclude it's too small. But when you take into account how these funds are guided and spent and the enormous improvement in efficiency, then it's not too small. On the other hand, you could argue that it's too large as I understand OMB is suggesting these days. They contend that small businesses cannot absorb and utilize such funds. Such judgment is ludicrous when we consider the size and capacity of small business in this country.

After careful consideration, the Committee decided that 1 percent of agencies' R&D budgets, excluding in-house research, was an appropriate amount to fund the SBIR programs.

On September 22, 1981, the Committee ordered an amended version of S. 881 favorably reported on a rollcall vote of 16–0. The most significant amendments included the exemption of in-house research from the proposed 1 percent funding base, the designation of the Office of Science and Technology Policy (OSTP) as the primary overseer of implementation of the Act and the designation of the Small Business Administration to assist in administering the Act by protecting the interests of small businesses. The definition of "research and development" was also changed to conform with the definition currently used by the Office of Management and Budget in OMB Circular A-11, Section 44. In addition, language requiring agencies to set goals for funding for small business research and development was modified to reflect a percentage figure rather than a dollar figure as prescribed in the original bill.

In an October 6, 1981 letter to Senator Rudman, President Reagan expressed his support for the legislation. "Your concerns that small firms be able to participate equitably in Federal Research and Development is shared by the Administration," the President wrote. "In the long run, all sectors of the economy are likely to benefit from the increased competition and research incentives your legislation provide. I congratulate you on the leadership you have shown in advancing the interests of those small businesses which are the job-producing lifeblood of our economy."

On December 8, 1981 the Senate passed S. 881, by a vote of 90-0, and sent it to the House. After consideration by seven House Committees (the Energy and Commerce Committee, the Veterans' Affairs Committee, the Science and Technology Committee, the Foreign Affairs Committee, and Armed Services Committee, the Select Committee on Intelligence, and the Small Business Committee), a revised version of S. 881 (H.R. 4326) was approved by the House on June 23, 1982.

The House-passed H.R. 4326 was sent to the Senate as an amendment to S. 881 and was adopted in the Senate by a voice vote on June 29, 1982, clearing the way for presidential approval.

In addition to the changes previously mentioned, the version of S. 881, as signed by the President, differed from the Senate-passed version in the following ways:

> The name of the Act was changed from "The Small Business Innovation Research Act" to "The Small Business Innovation Development Act."
>
> The Act covered 10, rather than 5, Federal agencies. (These are: the Department of Defense, NASA, the Department of Energy, the Department of Health and Human Services, the National Science Foundation, the Department of Agriculture, the Department of Transportation, the Department of Interior, the Environmental Protection Agency, and the Nuclear Regulatory Commission.)
>
> The Act authorized 1.25 percent of extramural research funds to implement SBIR programs rather than the Senate 1 percent of extramural research funds.
>
> The Act specified a 4 year phase-in for all agencies except the Department of Defense which was allowed a 5 year phase-in. The Senate-passed bill prescribed a 3 year phase-in for all agencies except the National Science Foundation which was required to implement the full program in the first year.

The Act placed the primary oversight responsibility with the Small Business Administration; the Office of Science and Technology Policy was given a secondary role in overseeing the Act. This represents a reversal of the Senate version.

The Act requires the General Accounting Office (GAO) to report to the Congress on the effect of the bill on Federal R&D activities 5 years following the date of enactment. The Senate bill required GAO to report on the effect on Federal R&D activities 2 years following the date of enactment.

The Act requires agencies with R&D budgets in excess of $20,000,000 to establish goals for funding agreements in excess of $10,000 for research with small businesses. The Senate bill specified that agencies with R&D budgets in excess of $100,000,000 establish such goals.

The Act exempts the Department of Energy's atomic research defense program from the research funding base upon which the 1.25 percent to fund the SBIR is applied. The Senate version placed a 1 percent cap on the amount of money that could be taken from research in government-owned, contractor-operated facilities (where DOE's atomic energy defense program is conducted).

The Act contains a "sunset" provision requiring the program to expire in October 1988. The Senate version had no such provision.

The President signed the bill into law (P.L. 97-217) on July 22, 1982.

Since that time, Senator Rudman has continued to work for the Act by taking an active interest in the implementation of the new law. On November 18, 1982, the Senator, concerned that certain agencies were not implementing the law as well as they should, wrote to President Reagan, and assured the President that he was "prepared to take whatever Congressional action is necessary to insure that the programs mandated by P.L. 97-219 are established in accordance with Congressional and Administration intent." The Committee is continuing its vigilence to ensure effective implementation of the law.

### B. SMALL BUSINESS PATENT REFORM LEGISLATION

The University and Small Business Patent Procedure Act was originally passed by the 96th Congress to encourage invention and innovation. Under the legislation, Congress, for the first time, granted automatic patent rights to small businesses and universities on inventions resulting from Federally funded research. At the same time, Congress sought to make the Patent and Trademark Office (PTO) self-sustaining by authorizing the PTO to collect from all patent recipients 50 percent of the cost of filing, issuing and maintaining patents. Prior to October 1982, the effective date of P.L. 96-517, patent fees reverted to the General Treasury, and Congress was required to separately appropriate funds to operate the office.

Early in the second session of the 97th Congress, the Administration submitted a bill, S. 2211, to amend P.L. 96-517. Under S. 2211, the amount patent recipents are required to pay would have increased from the 50 percent mandated by the Patent Procedures Act to 100 percent. Moreover, enactment of the legislation would have doubled U.S. patent fees before the substantial increase legislated in P.L. 96-517 even went into effect. (Prior to passage of P.L. 96-517, all patent recipients paid an average flat fee of $235.)

As Chairman of the Small Business Committee and the State, Justice, Commerce Appropriations Subcommittee which oversees the Patent and Trademark Office (PTO), Senator Weicker was concerned that the 100 percent recovery fee proposed by the Administration would have a strong chilling effect on small business innovators. For that reason, on March 31, 1982, he introduced a substitute bill (S. 2326) which set up a two-tiered fee schedule to allow small businesses, independent inventors, and non-profit entities to pay 50 percent, rather than 100 percent, of the cost of patent user fees.

While patent user fees are justified in this time of necessary budget restraint, many Members believe the approach embodied in S. 2211 failed to recognize the particular needs and circumstances of innovative small businesses, as well as those of universities and independent inventors.

At the 100 percent level dictated by the Administration's proposal, all recipients of U.S. patents would have been required to pay a minimum of $800 for filing and issuance fees, and a minimum of $2,400 in maintenance fees. While these costs are not likely to pose significant financial burdens for large firms, Senators were concerned they could discourage small businesses and independent inventors from applying for patents.

Senator Weicker's two-tier patent fee system, proposed under S. 2326, cut those fees in half. Under his proposal, small firms would pay $400 in filing and issuance fees and $1,200 in maintenance fees. The maintenance fees would be paid 3½, 7½, and 11½ years into the life of the patent. (This represents costs to the patent holder of $200, $400, and $600 respectively.) In addition, while the Administration's proposal specified that patent recipients pay 100 percent user fees to be determined by the patent office, S. 2326 set these fees in statute and required that, with the exception of one consumer price index adjustment, any further increases were to be determined by the Congress.

S. 2326, which also included a three-year Patent and Trademark Office authorization bill, was referred to the Senate Judiciary Committee. The Judiciary Committee took no action on S. 2326; however, it favorably reported a House companion bill, H.R. 6260, on July 6, 1982.

The House Judiciary Committee incorporated the main provisions of S. 2326 in H.R. 6260 and added a section permitting arbitration of patent disputes when agreeable to both parties involved in the controversy. In addition, while the Senate measure would have allowed one consumer price indexing adjustment of the fees specified in the bill, H.R. 6260 made such adjustment automatic every 3 years. The House version of S. 2326 was unanimously approved by the House Judiciary Committee on May 11, 1982, and passed the full House by a voice vote on June 8.

The full Senate adopted H.R. 6260 by voice vote August 17, 1982.

The President signed the measure into law (P.L. 97-247) on August 27, 1982.

## CHAPTER FOUR: SMALL BUSINESS AND COMPETITION

During the 97th Congress, the Committee examined two trends with the potential to have a devastating impact on the ability of small business to compete in the open marketplace: the growing concentration of economic power in the hands of a few; and the growing tendency of the Federal Government to compete with the private sector in providing goods and services to its agencies and offices.

Federal antitrust laws exist to protect the business community from anti-competitive practices and excessive economic concentration. OMB Circular A-76 spells out the basic Executive Branch policy of reliance on the private sector to supply the goods and services needed by the U.S. Government. The Committee analyzed the Administration's willingness to enforce both of these broad business protections and learned that in both areas, improvements could be made.

### A. FEDERAL ANTITRUST POLICIES

During the 97th Congress, the Small Business Committee became extremely concerned about what appeared to be a gradual lessening of enforcement of, and adherence to, the nation's antitrust laws. Two hearings were held, on December 1, 1981, and on September 9, 1982, to examine current policies and practices within the Administration and the agencies responsible for administering and enforcing antitrust laws.

It is the feeling of many Members of the Committee that if economic recovery is to occur, it is absolutely imperative that the economy remain competitive. In that regard, it is especially important that small business, the expansion of which is crucial to the recovery, not be hampered by illegal, noncompetitive acts. The antitrust laws are the first line of defense against excessive economic concentration. In the interests of a free, competitive economy, Committee Members believe there must be vigorous enforcement of these laws.

Senator Gorton, Chairman of the Subcommittee on Productivity and Competition, which held the December 1 hearing on antitrust enforcement, summed up the concerns of many Members when he said that recent "broad statements about the philosophies of antitrust enforcement" by Administration spokesmen, had "alarmed many of us in Congress." According to Senator Gorton:

> These statements indicated that those charged with Federal antitrust enforcement disagree with some of the laws on the books, or with a clear line of Supreme Court precedents interpreting them. We were upset by the implication that those administration officials apparently did not intend to ask the Congress to change laws with which they disagreed but rather would attempt unilaterally to mold the laws to fit their philosophy through a policy of selective enforcement.

> The reaction of the Congress has been swift and strong. There is widespread bipartisan agreement that a highly competitive, free market economy can be guaranteed only by vigorous enforcement of all the antitrust laws. Such an economy is, of course, an essential element in the administration's program to restore this country's economic health.
>
> This is especially true at a time at which we are engaged in a major effort to rid the country of unnecessary and burdensome Government regulation. Changes in the antitrust statutes must be made only directly—by action of the Congress.

Senator Gorton said he was concerned that a recent merger wave had been "fueled" in part by statements and actions by the Administrator. Specifically, Senator Gorton cited the following:

> The Robinson-Patman Act, which is designed particularly to protect small business against price discrimination, has been labeled by administration spokesman as a "dreadful piece of legislation" (Dunn's Review, August 1981), full of "absurdities" (American Lawyer, July 1981) and an "unjustified protection for small business" (N.Y. Times, April 26, 1981);
>
> The Administration seems to dismiss resale price maintenance as being rarely cause for antitrust concern, despite the fact that such conduct clearly and undisputedly violates existing law, and without the slightest hint of recognition by the Administration of the fact that such conduct often severely restricts the freedom of small businesses to respond individually to the competitive conditions they face in their market;
>
> Suggestions have been made that the Administration may abondon enforcement in the area of predatory pricing, apparently because of doubts that it really occurs. Members of the small business community are painfully aware that it does in fact occur, almost always with the result that small firms are driven out of business.

Testifying at the first hearing were Dr. James C. Miller, Chairman of the Federal Trade Commission, William F. Baxter, Assistant Attorney General, Antitrust Division, of the U.S. Department of Justice, and representatives from three major national small business associations.

Dr. Miller made a "promise . . . to the Members of the subcommittee that I will enforce the antitrust laws," but added: "I think that we need to be guided by what the courts have said, but we also need to be guided, especially at the stage where we are trying to determine how to spend our resources, buy the economic ramifications of proposed mergers and other activity that come under the antitrust rubric. We must use common sense, it seems to me, in trying to make sure we give the public the biggest bang for its buck in terms of resources devoted to antitrust enforcement."

Miller added that it was his belief that the suitable remedy to any perception that antitrust laws were not being enforced as stringently as they might be should come through toughened-up legislation passed by the Congress.

Attorney General Baxter drew critisicism from Senator Nunn when, at one point during his testimony he said that reduced competition "is good for small business."

> Senator NUNN. If you make a mistake and fail to approve a merger that would have been competitive . . . that mistake and that failure is good for small business?
>
> Mr. BAXTER. Yes. A merger that is strongly competitive and reduces the costs of merging firms, and enables them to put out a product at lower costs and lower price and to capture a bigger marked share, will tend to drive out competitors, whomever they may be.
>
> Senator NUNN. We must not be communicating. You really believe that when you make a mistake and reduce competition that is good for small business? . . . I have never heard that kind of testimony, frankly. I can understand why, Mr. Baxter, there are people around the country and people in Washington that think that some of your statements have given the green light to the kind of merger wave that we are seeing occur.

Mr. Philip Friedlander, Vice Chairman Small Business Legislative Council, responded to the statements of Baxter and Miller:

> While fond of remarking that bigness is not badness, they (Baxter and Miller) in fact appear to believe that as a general rule bigger is better on efficiency grounds . . . Both officials, while giving some lipservice to the Robinson-Patman Act, repeatedly have criticized it, specifically assert that it does not help small business, and are plainly disinterested in enforcing it . . . The atmosphere which they are creating is clear, at least it seems so to us. It is now open season on the antitrust laws. Large companies may now feel free to engage in what might be illicit antitrust conduct, for this administration may well turn its back on all but the most blatant violations . . .
>
> If we in the small business community are upset about anything, it is the attitude which we find totally unacceptable in terms of the enforcement of the law and signals the larger companies are receiving. It might help if these senior officials would stop talking so much about not enforcing the law.

Mr. Baxter testified a second time before the Committee on September 9, 1982, when a joint hearing between the Small Business Committee and the Appropriations Subcommittee on State, Justice, Commerce, the Judiciary and Related Agencies was held to further review the Justice Department's enforcement policy with regard to antitrust, and to study the Department's newly-released revisions to the merger guidelines.

At that hearing, Senator Weicker told Mr. Baxter he was, "disturbed by some of the signals the Justice Department's Antitrust Enforcement Division is sending these days. You, in particular, by recent statements, have indicated that in some cases the question of whether to enforce the law or not to enforce it is something that may be left up to your discretion. Now, that is not the way I interpret the law, and I do not think that is the way Congress meant the law to be interpreted when it was enacted."

Senator Nunn seconded those views saying: "While the Department of Justice must be given considerable flexibility in its prosecutorial approach to specific factual situations, such discretion does not translate into a wholesale refusal to enforce the statutes which are on the books and which have been clearly interpreted by the courts."

In his defense, Mr. Baxter said:

> One could come to my job with a rather passive, inactive law enforcement attitude that the job has nothing to do with the formation of policy, that is simply reading the most recent Supreme Court cases and bringing those enforcement actions which happen to correspond with them without any thought of whether one is improving or damaging the performance of the economy.
>
> I could understand such an attitude toward the responsibilities of the office, but I do not share it. I share, rather, the attitude of most my predecessors that the job is, in significant part, one of policymaking, one of education, one of urging upon the courts what industrial organization economists have learned in recent years, and we have done that. We have filed numerous briefs in many courts, urging the courts to change their views.
>
> I make no apologies for any of that. I intend to go right on doing it, and I think that is precisely what is called for by the responsibilities of the job.

The differences between Committee Members and Mr. Baxter on the matter of resale price maintenance violations and their enforcement became evident in the following exchanges:

> Senator RUDMAN. So you are telling us this morning that you intend to enforce the law in this area.
>
> Mr. BAXTER. Yes. Now, I don't want you to misunderstand what I am saying. I am not saying that resale price maintenance is unlawful in every context in which it appears. Indeed, quite the contrary; it should be the law, although the Supreme Court's language has been very, very sweeping and unfortunately so.
>
> Senator NUNN. On that point, you said, as I understand it, that you acknowledge the Supreme Court has said that those types of arrangements (resale price fixing) are illegal per se.
>
> Mr. BAXTER. Indeed—
>
> Senator NUNN. All right. You just got through saying a minute ago that those practices are desirable in some cases.
>
> Mr. BAXTER. Yes, they are desirable.
>
> Senator NUNN. Now, that is your opinion, right?
>
> Mr. BAXTER. Yes.
>
> Senator NUNN. That is not the law, though.

> Mr. Baxter. No, no.
>
> Senator Nunn. There is a difference between your opinion and the law.
>
> Mr. Baxter. No question about that.
>
> Senator Nunn. All right. But now what, as the chief enforcement officer of the antitrust laws, is your enforcement position . . . if these practices are occurring? Are you going to enforce the law as it now exists?
>
> Mr. Baxter. We are going to use our resources to enforce the antitrust laws starting with those instances that do the largest amount of harm to consumers and coming on down as our resources last."
>
> Senator Nunn. That sounds as if your priorities are based on your opinion rather than on a broad enforcement of the law; that you are going to take those areas that you don't agree with of the law and you are going to make them on the bottom line of your priority list. Is that what you are telling us?

Mr. Edward Walter, President of Compumart Corporation testified on the impact of antitrust enforcement on his small business. Referring specifically to his company's experiences with Apple Computer Corporation, he said:

> My company became an idealogical victim to a philosophy of a dominant supplier who boasts an independent dealer network in the face of vague and unwise controls, cuts off dealers of long and good standing without warning, and introduces controls which provide that every customer pay for the same services whether they are needed or not.

Mr. Thomas Mauro, of the Small Business Legislative Council, expressed these views:

> Congress has not changed the policy which was created when the antitrust laws were enacted. Accordingly, those who are responsible for the laws should not ignore that policy and cannot analyze antitrust problems on a technical, economic basis. The second point I would like to make is simply that the interest of small business must be taken into account by the Department of Justice or the Federal Trade Commission when either enforces the antitrust laws . . .
>
> We are witnessing today, determined efforts to reverse and effectively gut ninety years of antitrust enforcement tradition. Such efforts constitute grave and very real threats to small business and to the country. The vitality of small firms and of the small business sector is threatened by the relentless and sophisticated accumulation of power and wealth by the bigs, as it has been in no other time in our history . . . it is the smalls, not the bigs, that lead in innovations. And it is the small business unit upon which we must rely to provide the essential element of competition so as to protect all of us against higher prices,

> the divisions of markets or end customers, and even price fixing.
>
> We are distressed that these values do not seem to have a place in the Government's antitrust program today.

Several Members of the Committee continue to be deeply concerned about the antitrust policies of the Administration, and particularly, the enforcement policies articulated by Mr. Baxter as they affect small business. As Senator Weicker stated at the September 9 hearing, "small business owners have a right to a free and open market where they can compete fairly and equally without fear of predatory pricing, dictates from manufacturers, and unfair competition from larger and powerful firms."

It is expected that this issue will continue to be a focus of the Committee in the 98th Congress.

### B. GOVERNMENT COMPETITION WITH SMALL BUSINESS—S.J. RES. 93

It has long been the stated policy of the United States Government to rely on the private sector to supply its commercial goods and services. Since 1952, the policy has been embodied in successive Administration policy directives to the procuring agencies. The current executive policy on contracting-out is contained in OMB Circular A-76, a directive that summarizes the Government's general policy of relying on the private enterprise system and outlines the method for comparing costs between government-run (in-house) operations and functions that are contracted-out to private industry.

Despite the existence of this official government policy, Federal agencies have continually assumed and retained many functions that could be performed by private industry. In fact, according to a 1981 GAO study, Federal employees currently perform 11,000 commercial or industrial activities that could be performed by private business often at a lower cost than is now being paid. Taxpayers pay nearly $19 billion for these goods and services, something many small entrepreneurs claim amounts to a government subsidy for competition with private industry.

Small business owners are concerned about these increasing Federal intrusions into the marketplace. In fact, under the sponsorship of the SBA Office of Advocacy, a group of concerned small business owners formed a Task Force on Government Competition with Small Business and began to investigate the extent of the problem.

The task force findings, published in March 1980, categorized and analyzed hundreds of commercial and industrial functions now performed by government employees. Printing and binding, data entry and processing, food services, laundry service, audio-visual production, library services and research are just some of the current activities performed by Federal employees that the task force concluded could be performed by small firms. The task force conservatively estimated that $3 billion could be saved if the government contracted-out for these functions.

The Subcommittee on Advocacy and the Future of Small Business, chaired by Senator S. I. Hayakawa, took the lead in examining the government competition issue during the 97th Congress.

On June 22, 1981, Senator Hayakawa introduced S.J. Res. 93, a resolution that would have statutorily reaffirmed the existing Executive Branch policy of reliance on the private sector for the supply of the government's commercial goods and services. That resolution read as follows:

> **S.J. RES. 93**
>
> Whereas it is the function of the Government to establish Federal policies and manage Federal programs established by or pursuant to law; and
>
> Whereas it is the function of the private enterprise system, which is the primary source of national economic strength, to provide goods and services needed in that endeavor; and
>
> Whereas optimum efficiency, economy, and productivity can be achieved if the Government relies on competitive procurement ments from private enterprise for its needed goods and services; and
>
> Whereas in a democractic free enterprise system, the Government should not compete with its citizens: Now, therefore be it
>
> Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That it is the general policy of the Government of the United States to rely on competitive private enterprise to supply the products and services it needs whenever competitive industry prices are available. This policy shall be administered by the Director, Office of Management and Budget in coordination with the Administrator, Office of Federal Procurement Policy.

During testimony before the Senate Governmental Affairs Subcommittee on Federal Expenditures, Research, and Rules, on May 19, 1982, Senator Hayakawa pointed out that S.J. Res, 93 "does not reflect a shift in government policy; rather, it is a clarification of an existing policy that has been subject to varied interpretation and shifts in its emphasis over the years."

Senator Hayakawa testified:

> The intent of S.J. Res. 93, . . . is forthright and simply stated, as follows: To clarify and reaffirm that it is the basic policy of the government of the United States to rely on the competitive private enterprise system to provide needed goods and services.

Concurrent with the introduction of S.J. Res. 93, the Subcommittee on Advocacy and the Future of Small Business began a series of hearings to examine the issue of government competition with small business. On June 29, 1981, the Subcommittee heard from members of the SBA Advocacy Task Force on Government Competition and other small business owners about their first-hand experiences with government intrusion into the marketplace. The Chairman of the task force, Mr. Dale Nelson of Des Moines, Iowa, reviewed the 46 recommendations made by the group and called for passage of S.J. Res. 93 as a means to rectify a serious small business problem. The Subcommittee also received testimony from GAO and OMB on the extent of the government competition problem. Clifford Gould, Director of Federal Personnel and Compensation at GAO, reported:

> . . . Federal agencies are using contractor personnel for work that should be done in-house, they are using, government employees to provide commercial services that contractors could provide at a lower cost. Executive branch agencies, with few exceptions, have made little progress to implement Circular A-76's longstanding policy to rely on the private sector for goods and services. Although this policy has existed for more than 25 years, OMB information shows that as many as 400,000 Federal employees are currently operating more than 11,000 commercial or industrial activities at a cost of almost $19 billion annually. These employees represent almost one-fourth of the total executive branch civilian work force. Many of these Federal activities provide services—such as janitorial, guard, keypunching, and laundry services—that the private sector could often provide more economically. OMB has estimated that savings of $3.6 billion could be achieved during fiscal years 1982 and 1987 if all agencies fully implement Circular A-76.

Donald E. Sowle, Administrator, Office of Federal Procurement Policy, OMB, testified that:

> This country has traditionally looked to the private sector to pave economic paths because of its willingness to take risks, seek innovative solutions to new needs and old problems, reduce costs, and create and use new technology. In this respect business adds to Federal, State, and Local tax revenues instead of using the revenues which is the case when government provides its own needed goods and services. In addition, competitive procurements foster efficiency, economy, and increase productivity in the Federal government. We estimate that the government currently operates thousands of commercial or industrial activities with an annual operating cost in excess of $20 billion and a capital investment of a similar amount. The vast majority of these activities have never been subject to competition. Available statistics indicate that we could save at least 20 percent of our operating costs weighed against the cost of performing the same work in-house.

On August 28, 1981, the Subcommittee held a field hearing on government competition in Los Angeles, California. Again, the panel heard from small business owners whose businesses had been hurt by government competition. Gene Zerlaut, President of DSET Laboratories of Phoenix, Arizona, a high-technology small business, summarized his views this way:

> Confronted with the realities of *de facto* competition from Federal operated laboratories, and of government supported university testing, private sector laboratory managers are extremely reluctant to risk capital on test

> markets so totally distorted by unfair competition. It is this resistance that, in magnificent circular logic, has caused Federally operated agencies and laboratories to justify their own "commercial" tax activities. They become so convinced of the "rightness" of their activities that they develop the myopia-induced belief that they alone possess the only true competence—even when surrounded by equal or better capabilities in the private sector.

Mr. Charles Evans of Evans Associates of San Mateo, California, stated:

> Generally, indirect competition comes about from grants and contracts let to universities and other federally sponsored laboratories, as well as national laboratories. They purchase equipment with tax revenues from the Federal government—much as we have in our laboratory with private—capital in an attempt to grow, innovate, or in some cases, build empires. For a variety of reasons they have gone outside the academic research community to find users of this equipment. They then offer these commercial services at a very unfair rate because they do not have to recognize the cost of equipment, they operate in investing facilities at little or no charge, and can use a graduate student, professional staff, or faculty labor, which does not have to compete with the private sector. As such, State and local governments become "co-conspirators" insofar as they underwrite a portion of the costs.

On November 4, 1981, the Subcommittee held the third in its series of hearings on government competition with the private sector. At this session, government witnesses presented testimony on their procedures for contracting-out to private industry. At the hearing, Senator Hayakawa reemphasized the Administration's support for increased reliance on the private sector to supply commercial goods and services to the government. He read a letter from OMB Director David Stockman, in support of S.J. Res. 93 and similar proposals.

Stockman "enthusiastically" endorsed the resolution, writing in part:

> The Reagan Administration would welcome a clear statement of intent by the Congress to support the policy that the Government should not compete with its citizens, and should rely on the competitive private enterprise system for needed goods and services. We, therefore, enthusiastically and fully support the Senate Joint Resolution 93, which you introduced on June 22, 1981. It is an excellent means to clarify to the public and private sectors alike that it is truly the Government's policy to rely on the private sector for needed commercial and industrial goods and services. The Resolution provides timely support for President Reagan's quest for a new, revitalized approach to strengthening this country's economy. Economy and efficiency in Government and reward of the private

> sector for initiative and productivity are necessary ingredients in our formula for economic renewal.

Stockman estimated that adoption of the procedures outlined in S.J. Res. 93 could eliminate as many as 154,000 Federal jobs, thus transferring that employment to the private sector, and that it could result in savings to the government of more than $3 billion by 1987.

The Department of Defense also indicated its support for S.J. Res. 93. Yet, later the Department supported the House Armed Service Committee's move to place a moratorium on the use of DoD monies to perform A-76 studies. That six-month moratorium expires on April 30, 1983.

Although Senator Hayakawa's resolution was not acted on during the 97th Congress, OMB is in the process of revising Circular A-76 in the attempt to stimulate greater private sector participation in the Federal marketplace.

The revision, like S.J. Res. 93, is of considerable interest to the Committee. However, unlike the resolution, the OMB revisions to A-76 may advocate the "umbrella" or consolidated contracts method of contracting, a proposal that this Committee believes could have disastrous effects on the small business community.

### C. UMBRELLA CONTRACTS

In the past, agencies attempting to comply with OMB Circular A-76 have conducted function-by-function reviews of in-house commercial/industrial workloads for purposes of contracting-out to the private sector. The result has been the award, function-by-function, of support service contracts to individual companies, many of which are small or minority businesses.

Lately however, many Federal agencies, particularly the Department of Defense, have started to consolidate many of these individual contracts into a single, large "umbrella" contract. Under the consolidated contract concept, a single contractor is responsible for the work now being performed by several contractors. According to the Administration, these consolidation efforts simplify contract administration, cut costs and help to facilitate agency compliance with OMB Circular A-76. Some argue that current small business prime contractors will be able to retain their contracts as subcontractors.

Several Members believe, however, that consolidated contracts could have a detrimental impact on small and minority business programs, particularly the 8(a) program. By combining several contract requirements under one umbrella, the government is effectively denying small business participation at the prime contract level. Theoretically, small firms could bid on these large contract packages. However, as a practical matter, they will not bid because in most cases, these packages exceed their capabilities and experience. Realistically, the only offerers for such work have been, and will continue to be, large companies with service/oriented divisions, such as Northrop, Lockheed, RCA, and Boeing. In practice, contract consolidation could result in a large-business set-aside, which runs counter to the spirit and intent of the small Business Act and related Federal regulations.

Although former Deputy Secretary of Defense Frank Carlucci issued a memorandum calling for protection of small business interests on currect and future contract consolidations, this Committee intends to keep a close watch on agencies' practices of consolidating contracts and on revisions to OMB Circular A-76, so that small firms are assured of receiving their fair share of any increased contracting opportunities that may result from more aggressive implementation of OMB Circular A-76.

### D. PETROLEUM MARKETING PRACTICES

At the request of Senator Dixon, the Senate Small Business Committee conducted informational hearings on the impact of petroleum marketing practices upon small businesses in Illinois. The hearing was held in Chicago on October 12, 1982.

The objective of the hearing was to review concerns regarding marketing practices between jobbers and refiners, jobbers and dealers, and between dealers and refiners. In most cases, both jobbers and dealers are small businesses.

Relations between these entities have, in the past, been the subject of frequent examination by Congress and various agencies of the Executive branch. Allegations of predatory pricing or price subsidization by the major refiners date back to at least 1935. It was not unexpected that such concerns would resurface following the removal of Federal price and allocation controls in 1981. While the Committee did not try to document these allegations, it provided an opportunity for witnesses to present their testimony on these and related issues.

Witnesses highlighted the following points:

> Demand for petroleum products has dropped and shows no sign of returning to earlier sales levels. Since 1978, total U.S. consumption for petroleum products has declined by roughly 20 percent. This fact is reflective of energy conservation, fuel switching, and product price sensitivity.
>
> Increased operating costs, triggered in part by inflation, has affected every phase of the petroleum industry, and has been especially difficult for petroleum marketers.
>
> Removal of Federal price and product allocation controls has permitted significant reorganization within the market over a short period of time. The removal of Federal controls has emphasized the need for production and marketing efficiencies.
>
> There have been shifts in consumer buying patterns from "traditional" service stations to "gas and go" operations. Many products and services formerly provided by service stations are now offered by nationally recognized firms and retailers as well as franchised organizations providing, for example, muffler and transmission repairs/installations.

While not all of these changes affect each component of the petroleum marketing community, the collective impact has been significant. In this context, it was not surprising that many dealers and jobbers expressed considerable concern for the future of their enterprises. Nor was it surprising that some witnesses sought relief through Federal legislation in the form of divestiture/divorcement proposals. Regardless of the outcome of such legislation, the issues surrounding petroleum marketing practices are likely to receive continued attention in the 98th Congress.

In his closing statement, Senator Dixon summarized the issues this way:

> We are all concerned about the consumer getting a fair price, and that is all a part of this scheme of things, too. I would want to say to everyone in this room that I come here with no preconceived notions, no fixed ideas of what ought to be done. What has happened here is a valuable education for me, and I know it will be for every Member of the Small Business Committee.
>
> You are an important part of our economic experience in this country, every one of you in this room, and we are concerned about you, particularly in these difficult times. I know I speak for the entire Committee as well as the Congress when I say that the concerns of you and the consumer in the country will be uppermost in our minds.

## CHAPTER FIVE: SMALL BUSINESS AND GOVERNMENT PROCUREMENT

While small businesses are full and active partners in the economy as a whole, historically they have had only limited access to the nation's single largest consumer—the United States Government. Currently, the small business sector receives less than 25 percent of the Federal procurement budget, which now exceed $110 billion each year. This occurs despite the fact that small companies comprise approximatley 90 percent of this nation's businesses and account for about half of the Gross National Product.

The Committee has been greatly concerned over this discrepancy and has devoted a great deal of its time and resources to analyzing why small firms receive so little of the total U.S. procurement dollar.

After meeting with many small government contractors associations, the Committee concluded that small firms have a difficult time penetrating the Federal marketplaces for a variety of reasons. For example, many small firms simply do not know how to market their goods or services to the Federal government. Other small firms avoid the Federal marketplace due to the statutory and regulatory paperwork requirements that are tied to Federal contracts. Still others complain that they cannot break through the maze of complex Federal rules and regulations, some of which apply only to Defense Department contracts, some of which apply to contracts with other agencies, and some that apply to both. Some small firms complain that they are not notified of Federal contracting opportunities in a timely manner; others object to being paid months after an order is delivered, once they do receive a government contract.

During the 97th Congress, the Committee took steps to eliminate procurement obstacles faced by small businesses. By holding hearings on procurement related problems, by moving key procurement legislation through the Senate, and by offering small business owners the opportunity to familiarize themselves with government contracting practices at Member-sponsored procurement conferences, the Committee has attempted to ensure that small firms receive their fair share of future U.S. procurement budgets.

### A. THE PROMPT PAYMENT ACT

On May 21, 1982, small firms that do business with the Federal Government won a major battle with the enactment of the Prompt Payment Act, legislation authored and introduced by Senators Danforth and Weicker.

The new law (P.L. 97-177) which became effective October 1, 1982, requires Federal agencies to pay their bills within 45 days or face interest penalties. Under the legislation, those interest penalties must come out of the agency's existing operating budget, and no additional monies may be appropriated to cover them.

The need for the legislation was stressed at a Small Business Committee hearing where witnesses told Members that although they had received contracts with the government for goods or services, they were having trouble getting their bills paid on time.

Witness Ron Chainey, the owner of a cleaning business in Connecticut, told the Committee that he had been trying for five months to collect $10,000 for services delivered to the U.S. Navy. Mr. Chainey pointed out that he was not alone and told Committee Members many small firms like his had been forced to borrow money at high interest rates while they waited months for the Federal goverment to pay its bills.

The General Accounting Office confirmed Mr. Chainey's charges. In a study completed in 1978, GAO showed that 39 percent of the Federal Government's bills had been paid after their due date. In a follow-up study, completed in 1981, it was determined that late payments had been costing the private sector between $150 and $375 million each year. Furthermore, the study pointed out that "* * * adequate corrective actions have not yet been taken. The Treasury's monitoring of Federal bill-paying practices has been ineffective, and responsible agency headquarters offices apparently do little payment performance monitoring themselves."

Late payments are particularly harsh on small businesses, since they rely on the revenues and payments from each contract to meet their other obligations. Due to tight cash flow and narrow profit margins, each payment must be timely for the small business to meet its fixed expenses. For some small businesses, repeated late payments by a Federal agency can inadvertently force the firm into bankruptcy.

In response to this growing problem, Senators Weicker and Danforth introduced S. 1131, the Delinquent Payments Act, on May 6, 1981. The legislation called on the Federal Government to adopt a standard private business practice of paying for goods and services delivered in a timely fashion, or paying interest on the amount due. The legislation had the strong broad based support of the Slow Pay Coalition, a group made up of over 20 national trade associations.

On May 13, 1981, Senator Weicker testified about the devastating impact of late payments on small firms before the Governmental

Affairs Subcommittee on Federal Expenditures, Research, and Rules. He pointed out that many small firms, already hard pressed to survive in today's depressed economy, can ill afford the added financial pressure of late Federal payments. The Chairman noted that monies owed a company accumulate no interest, meet no payrolls, nor carry any other operating expenses. For that reason, the Chairman said late payments mean net losses. Said Senator Weicker:

> One-third of all Federal bills are paid late according to the GAO. This is not just bureaucratic redtape; it is an irresponsible and insupportable practice by what is one of the largest industries in the country.
>
> Moreover, it is inconsistent! Imagine, if you will, how the Internal Revenue Service would react if you paid your taxes 6 months late, * * * We all know how they'd react—they would slap penalties and interest charges on you so fast, you wouldn't know what hit you!
>
> And yet Federal agencies are routinely paying their bill whenever they happen to get around to it, with no penalties or interest charges.
>
> In the meantime, small businesses are awaiting payment—businesses that have neither the cash flow to carry these overdue accounts for a long time, nor the administrative personnel necessary to cope with a large number of accounts receivable. They are being forced to take out short-term loans at high interest just to meet the weekly payroll. These small businesses have to pay their own bills on time or face severe interest charges.

The Delinquent Payments bill was marked-up and reported by the full Committee on Governmental Affairs, on December 9, 1981. It was passed by the Senate on December 15, 1981. By the time it was passed, 63 Senators had co-sponsored S. 1131. The House adopted its version of the bill, H.R. 4709, on March 23, 1982. The legislation, now called the Prompt Payment Act, was enacted in final form and signed into law (P.L. 97-177) by President Reagan on May 21, 1982. (A copy of the law may be found in Appendix I of this document.)

Specifically, the law requires agencies to pay for a good or service delivered within 30 days (except for perishable goods), or to pay an interest penalty on the amount due. During House consideration a provision was added to allow a 15-day "grace period" after the 30th day for payments to be made. However, if the payment is not made within the grace period, interest accrues from the 31st day.

Further, the law provides that the rate of interest charged to the government is determined by the Department of the Treasury. It also provides that agencies must pay the interest charges out of their regular operating budgets, and Congress is prohibited from authorizing additional appropriations to agencies with budget shortfalls.

The Committee believes that the Act will encourage government money managers to make payments in a timely fashion. The Committee will, however, keep a close watch on the implementation of the Prompt Payments Act.

## B. THE COMMERCE BUSINESS DAILY

One of the major impediments to small business participation in the Federal procurement process has been the lack of timely and adequate information about government contracting opportunities.

Section 8(e) of the Small Business Act and related procurement regulations requires the Secretary of Commerce to advertise contracting opportunities in the Commerce Business Daily. Federal agencies that wish to procure a good or service must synopsize their proposed bids or solicitations for publication in this document. The law and regulations also enumerate 10 exceptions to the requirement for publication of proposed procurement actions.

Currently, procurement advertising regulations provide a minimum 10-day notice period and a minimum bidding time of 20-calendar days. However, the Committee learned that, in practice, this time period is often waived where there are "special circumstances" or where there is an urgent need for the goods or services. In other words, what should amount to a cumulative period of 30 days for obtaining a solicitation and bidding on a contract, can be shortened arbitrarily, or even ignored, at the discretion of the procuring agency. Further, the Committee learned that the minimum bidding regulations apply only to formally advertised contracts; there are no time limits established in regulations for negotiated contracts, even though such contracts represent the bulk of Federal purchases.

To rectify this situation, Senators Weicker and Nunn, along with Senators Boschwitz, D'Amato, Dixon, Gorton, Hayakawa, Rudman, and Tsongas introduced legislation (S. 1947) on December 11, 1981, to improve the timeliness and thoroughness of the procurement information contained in the Commerce Business Daily. The legislation would have amended Section 8(e) of the Small Business Act by establishing new minimum time periods for publication of, and bidding on, government contracts.

Specifically, it would have provided for two periods to enable prospective contractors to submit timely bids or proposals. The first gave interested parties 15 days from the appearance of a notice in the Commerce Business Daily in which to request copies of a solicitation. The second time period was set up to provide at least 30 days from the issuance of a solicitation before a bid becomes due.

On February 17, 1982, the Subcommittee on Advocacy and the Future of Small Business, chaired by Senator S. I. Hayakawa, conducted a hearing on S. 1947 in San Diego, California. The full Committee conducted a second legislative hearing on the bill in Washington on March 4, 1982.

At these hearings, the Committee received testimony from small business owners on the usability of the Commerce Business Daily. These witnesses informed the Committee that all too often, synopses appear too late to permit an interested company to prepare and submit a timely bid or proposal. They added that this problem is compounded when synopses contain inadequate information, or are "misfiled" in the Commerce Business Daily. As one small business contractor summarized at the San Diego field hearing:

> If published synopses contain insufficient information, then the time required to make further inquiries of the agency can consume bidding deadlines. If I have to hunt through the entire publication, instead of the sections that may pertain to my line of business, the value of the CBD to my company is greatly reduced.

At the hearing, the Committee also learned that even when notices were complete and "proper," mail delays have further reduced the time bidders have to respond. These problems are particularly acute for companies located great distances from Chicago, where the Commerce Business Daily is printed and mailed. While some delays can be attributed to those subscribers who chose to have mail delivered by other than first class, even "priority" subscribers expressed similar concern about the "timeliness" of notices that are contained in the Commerce Business Daily.

Another common complaint voiced by the small business witnesses centered around agency abuse of the 10 statutory exemptions from advertising in the Commerce Business Daily. Several small business owners also testified that they believe many more procurements should be advertised under the provisions of the law than actually appear.

The Committee also received testimony from Federal procurement officials, the Department of Commerce, the Small Business Administration, and the U.S. Public Printer on the compilation, publication, and distribution of the Commerce Business Daily.

When questioned by the Committee about synopses that violate the minimum time periods, the senior Department of Commerce official responsible for the preparation of the Commerce Business Daily attributed the variation between regulatory policy and agency practice to "time escape clauses" which are also provided for in the regulations. He added that in his view the Department has no "enforcement" authority over the procuring agencies to compel adherence to the regulatory timetables, and that the Commerce Business Daily staff has no actual control over procuring agency notices that are submitted beyond the regulatory guidelines established.

Another witness reported that although the Small Business Administration (SBA) periodically issues surveillance reports on agency compliance with the Commerce Business Daily requirements, these reports are ignored as often as the regulations themselves:

> By implementing this statute, I believe that compliance will improve because over the years the Small Business Administration's surveillance reviews and reports to agency leaders concerning the CBDs frequent non-compliance with the regulations have not resulted in any discernible improvement.

A spokesman for SBA, in response to a question of regulatory compliance said:

> Certainly in the surveillance that we do of procurement activities, there is a significant number of instances where they are not adequately complied with at this time.

The Administrator of the Office of Federal Procurement Policy (OFPP) admitted that enforcement of the Commerce Business Daily regulations was indeed difficult. Yet, he advocated administratively strengthening the existing regulations as the best method for improving the "timeliness" problems described by the small business witnesses.

On May 15, 1982, the Committee met to mark up S. 1947. The Chairman introduced an amendment in the nature of a substitute which incorporated many of the suggestions offered by witnesses during the hearings. The Committee amendment provided for fewer exemptions from advertising and then only when written justification is provided. During the mark-up session, Senators Levin and Nunn added an amendment to require approval of all sole-source procurements in excess of $100,000. Senator Levin added a second amendment to strike the current statutory exemption for advertising professional service or educational contracts.

The Committee ordered its amendment favorably reported on May 13, 1982. The bill passed the Senate by a voice vote on May 27, 1982. Similar legislation passed the House on June 8, 1982. However, non-germane amendments were added during House Committee consideration, of the legislation which held up final passage of the bill.

At the time the Senate adjourned on December 23, 1982, no further action had been taken with regard to S. 1947.

### *Alternative means for publishing and disseminating the Commerce Business Daily*

Although the Committee focused primarily on the establishment of minimum time periods for publication of, and bidding on, government contracts, several other issues relating to the Commerce Business Daily were raised during the Committee's consideration of S. 1947. The Committee was particularly interested in suggestions concerning alternative methods for printing and disseminating the document.

Department of Commerce officials suggested several innovative proposals for electronic transmittal of the information contained in the Commerce Business Daily. They reported that the Government Printing Office (GPO) now provides the Department with magnetic tapes of daily issues as the first step toward testing the Commerce Business Daily Data Retrieval Program. This project contemplates on-line computer retrieval of all, or part, of the present Commerce Business Daily hardcopy data base.

This Committee, along with the Joint Committee on Printing, also took an active interest in monitoring the Commerce Department's and GPO's joint efforts to solicit bids for production of the Commerce Business Daily outside of the government. Currently, the two agencies are studying the feasibility of printing the entire publication outside of the GPO. Technical proposals, solicited from the private sector, are being reviewed so that these agencies can better analyze the costs and benefits of contracting-out for the printing of the Commerce Business Daily. The composing functions are already performed by the private sector. However, neither agency contemplates transferring outside the government the information-processing or editorial functions relating to the Commerce Business Daily.

This Committee encourages all those concerned to continue their efforts toward improving the printing and transmittal of the Commerce Business Daily. The Committee believes that such activities will ultimately benefit the small business users of the publication by reducing mail delays and subscription costs. In addition, the Federal Government will benefit from reduced procurement costs because of the increased competition.

### C. DAVIS-BACON

On February 2, 1982, Senator Nickles chaired a Government Procurement Subcommittee hearing on the "Impact of the Davis-Bacon Threshold on Small Business Construction Contractors." The purpose of the hearing was to analyze how Davis-Bacon wage requirements had affected the ability of small contractors to bid on Federal construction contractors.

At the hearing, several small business owners testified that the current $2,000 Davis-Bacon threshold was too low. They argued that as a result of the low threshold, many small firms refused to bid on government contracts, because they would have to pay the "prevailing wage", which often is equal to the highest wage in the area. The contractors added that the Davis-Bacon Act disrupts their internal wage scales, artificially inflates their project costs, and causes undue paperwork burdens for them and other small firms.

Mr. Robert Killion, co-owner of the Tulsa Electric Company in Tulsa, Oklahoma, gave this example of how Davis-Bacon affected his company's ability to compete:

> About one year ago, Tulsa Electric was awarded the electrical contract on a pediatric and diagnostic clinic that was funded in such a way to fall under Davis-Bacon. At the time, the average Tulsa Electric worker was making $11.50 per hour. This was about the same wage as virtually all electricians in the Tulsa area. However, the published "prevailing" wage for this under Davis-Bacon was $13.65 per hour. I was, of course, forced to bid on this scale.

Another small business contractor expressed his views on the Davis-Bacon threshold this way:

> I believe the federal government should be improving the environment for small business rather than imposing artificial criteria which limit our opportunity to compete in any market we are qualified to work in * * *. There have been a significant number of laws and regulations put in place since 1931 that deal more effectively than Davis-Bacon with wages, working contractors, and government procurement activity without the disruptive effects of Davis-Bacon.

Despite the general agreement among small business witnesses that the Davis-Bacon threshold should be raised, there was little consensus on a recommendation for a new threshold. Suggestions ranged from $10,000 to $2 million. On the other hand, representatives of the AFL-CIO Building and Construction Trades Department advocated retaining the Davis-Bacon threshold at its present level. They argued that the Act's protections should be provided to all American workers, not only to those who are employed on contracts over a certain dollar volume. Legislation has not yet passed to alter the current Davis-Bacon threshold.

### D. RETAINAGE

During various meetings with construction industry representatives, the Chairman became aware of cash-flow problems that can arise when the government withholds a portion of a construction contractor's progress payments. This practice, commonly referred to as "retainage", was created years ago in order to protect the government's interests on construction projects. However, many owners of small contracting firms believe that because there are now other safeguards required on all Federal projects, the arbitrary withholding of up to 10 percent of each progress payment is duplicative and often counterproductive.

On October 28, 1981, Senator Weicker introduced S. 1782, the Small Business Contract Payment Procedures Act. As introduced, the bill would eliminate retainage for small business contractors if an adequate bond was provided and if the work was progressing on schedule and in a satisfactory manner.

In hearings before the Governmental Affairs Subcommittee on Federal Expenditures, Research and Rules, Chairman Weicker testified about the staggering impact of retainage on small construction firms:

> * * * Retainage was designed to insure that Federal construction contracts are completed satisfactorily. That is fine, but in the years since then, a new regulation was put on the books, requiring Federal contractors to post performance bonds on all jobs to guarantee completion. Clearly, with the performance bond as a guarantee, we do not also need retainage.
>
> * * * retainage was intended as an incentive for contractors to complete their work in a timely and speedy fashion. In fact, it appears that the opposite is true. With construction now being completed by many different subcontractors, the firms which complete the bulk of the work before the whole project is done have absolutely no incentive to finish up the final details quickly because retainages are not released until the owner accepts the whole finished building.
>
> Therefore, rather than hurrying to complete a job and then waiting months for payment, the contractors commit their resources to current projets where full payment can be expected, and they take their time on the Federal job.

The Senator pointed out that small contractors must cover an average of $200,000 annually in outstanding retainages, and that, as a result, most small contractors are forced to borrow, at today's high interest rates, just to cover the monies retained. That cost, the Senator added, is usually factored into a bid and passed along to the Federal government and the American taxpayer.

The Governmental Affairs Committee marked-up the legislation and reported it favorably to the Senate. The bill, then known as the "Construction Contract Payment Procedures Act," was passed by the Senate on October 1, 1982. The legislation was referred to the House Government Affairs committee and no further action was taken on the bill during the 97th Congress.

### E. PROCUREMENT REFORM

On September 16, 1982, Senator S. I. Hayakawa chaired a full Committee hearing on small business procurement reforms. The purpose of this hearing was to determine what legislative or regulatory actions are needed to stimulate increased small business participation in the Federal marketplace.

At the hearing, small business owners and Federal procurement officials testified on S. 2446, an omnibus small business procurement reform bill introduced by Senator Arlen Specter. Briefly, the bill would have required Federal agencies to justify sole source bids, to advertise bids in a timely fashion (similar to the provision passed in S. 1947) and to "break out" large systems procurements into smaller components. In addition, it would have authorized the SBA to establish arbitration panels to resolve contractual disputes, and establish a Small Business Procurement Advisory Committee.

Witnesses agreed that the most important section of S. 2446 related to component break outs. Currently, many small businesses are automatically shut out of the procurement process by the sheer size of the large systems contracts offered by the government—a practice which decreases competition and increases costs. Although defense procurement regulations provide for component break out, these rules have had little impact. Therefore, most small business witnesses agreed that legislation is sorely needed in this area.

The Committee also received testimony on the DoD Spare Parts Break Out Program at the hearing. The Committee learned that, although small businesses are certainly capable of competing on DoD spare parts contracts, several constraints, including the lack of technical data, legal ambiguities, and the inherent reluctance of many agencies and contracting officers to procure from a contractor other than the original manufacturer, currently hamper a firm's ability to compete for the contracts. Both government and small business witnesses indicated that the DoD Spare Parts Break Out Program could be improved substantially and recommended that SBA increase the number of Procurement Center Representatives available to assist DoD in improving its small business participation on spare parts break outs.

A recent SBA study indicates that DoD wastes millions of dollars annually as a result of non-competitive bidding on spare parts purchases. GAO recently reviewed these findings and concluded that SBA may have understated the potential for savings.

Witnesses added that aggressive implementation of the Spare Parts program could result in substantial cost savings. In fact, some advocated legislation in this area to complement the component break out provisions contained in S. 2446.

There was little consensus on the remainder of S. 2446, particularly on the provisions relating to the arbitration panels, and the bill was not reported out of Committee. The Committee intends to focus on procurement reform legislation—including the break out provisions—during future sessions of Congress.

### F. PROCUREMENT CONFERENCES

In order to provide small business constituents with information on how to do business with the Federal government, several Members of the Committee sponsored procurement conferences or similar meetings during the 97th Congress. The purpose of these conferences was to provide current and potential government contractors with information on how to market products and services to the government, how to prepare bids, how to become a subcontractor, and how to market goods overseas.

Without exception, the procurement conferences were well-attended and enthusiastically recieved by the small business community. One-on-one counseling sessions with Federal officials, prime contractor lectures on "nuts and bolts" procurement issues, and general discussion sessions highlighted these Conference activities. The Committee strongly believes that these Congressionally-sponsored events enhance the ability of small firms to participate in the Federal marketplace and begin to break down some of the barriers that impede small business involvement in government contracts.

The following is a list of the small business procurement conferences sponsored by Members of the Committee over the past two years:

Chairman Weicker: Procurement Conference—New Haven, Connecticut, October 22, 1981; Series of five "Get Down to Business" Government Assistance Workshops, designed to provide a wide variety of govenment counseling to business owners on topics such as tax assistance, financial assistance, management assistance, and export assistance—East Hartford, Bridgeport, Norwalk, Waterbury, and Norwalk, Connecticut, May 1982.

Senator Hayakawa: Procurement Conference—San Diego, California, February 17, 1982; Los Angeles, California, May 26, 1982; Sunnyvale, California, October 4, 1982.

Senator Boschwitz: Procurement Conference—Minneapolis, Minnesota, July 16, 1982.

Senator D'Amato: Procurement and General Business Conference—Rochester, New York, September 8, 1982.

Senator D'Amato has planned other conferences to be held in 1983. They are as follows: Long Island, New York, April 11, 1983; Albany, New York, June 1, 1983.

Senator Dixon: Procurement Conference—Springfield, Illinois, August 1981; Chicago, Illinois, August 1981, Chicago, Illinois, June 1982.

Senator Nunn: Procurement Conference—Atlanta, Georgia, September 1981.

Senator Baucus: Procurement Conference—Fairmont, Montana, June 7, 1981.

Senator Huddleston: Procurement Conference—Green River Area Development District/Kentucky, May 4, 1982, December 3, 1982; FIVCO Area Development District/Kentucky, September 14, 1982.

Senator Levin: Procurement Conference—Detroit, Michigan, April 1981; Farmington Hills, Michigan, October 1981; Farmington Hills, Michigan, February 1982, Warren, Michigan, April 1982; Muskegon, Michigan, May 1982; Detroit, Michigan, May 1982.

### G. TIMBER SALES SET-ASIDE PROGRAM

As mandated in 1958 by amendments to the Small Business Act, the SBA developed a Small Business Timber Sales Set-Aside Program. Under the program, certain timber sales are offered exclusively to small businesses, thereby insuring that small companies will be able to purchase some portion of the available timber. The primary objective of the timber set-aside program is to provide the small business community with its fair share of Federal timber sales contracts.

Under an interagency agreement, the timber sales set-aside progam is administered jointly by the SBA and the Department of Agriculture's U.S. Forest Service. Specifically, the SBA promulgates size standards to determine which firms are eligible to participate in the set-aside program. In 1965, the Agency established a timber size standard of 500 employees. In 1966, 1975, and 1980–1981, the SBA reviewed the timber size standard and sought public comments on the existing size definition. After each review, the SBA decided to retain the 500-employee standard.

In addition to its responsibility for determining program eligibility, the SBA monitors how the program operates in timber selling areas. The U.S. Forest Service is responsible for actually selling the timber under the program. This agency also is charged with assisting the SBA in calculating the small business share of Federal timber sales.

Recently, the SBA and the U.S. Forest Service completed their update of the five-year "base share" for each forest market area. The base share represents actual timber sales to small firms during the previous five years and is the base for triggering future set-aside sales within the market area.

Over the years, the timber sales set-aside program has been relatively successful. By making large dollar amounts of timber available to small companies, the program has given small businesses a stake in a highly competitive industry. In FY 1981, for example, small business received 74 percent of the 3,591 Federal timber contracts available nationwide. These sales amounted to 56 billion board feet of saw timber with an estimated value of $1.26 billion.

Yet, despite its success, the program has not been without its problems. Base share calculations, program administration, and regulations have been the brunt of criticism from large and small timber companies. Further, the base share calculations are regularly subject to challenges.

On February 19, the Small Business Committee held an oversight hearing on the timber set-aside program in Hot Springs, Arkansas. The acting Chairman, Senator Dale Bumpers, told witnesses that the Committee was concerned with the prospects for promoting a healthy, viable business timber sector. Senator Bumpers said:

> The timber program has been successful in making large numbers, and relatively large dollar amounts, of timber available to small businesses. On a national basis, during 1981, two thousand six hundred and fifty-eight (2,658) individual small business sales were made out of a total of three thousand five hundred and ninety-one (3,591) or seventy-four percent (74%). The sales amounted to 5.6 billion board feet of new timber with an estimated bid value of 1.26 billion dollars.
>
> Of the three national forests in Arkansas, the Ozarks, the Ouachita, and the St. Francis, in fiscal year 1981, there were one hundred thirty-one (131) sales that went to small businesses, with an estimated bid value of 30.6 million dollars.
>
> Despite the existence of the SBA timber set-aside program, there is growing evidence to indicate that small business involvement in the forest products industry is declining, and that the degree of concentration and control of the industry by large firms is growing. Some consolidation in any industry is likely to occur. Nevertheless, the Senate Small Business Committee is particularly concerned about the prospects for promoting a healthy, viable small business timber sector.

At the hearing, the Committee received testimony from SBA and U.S. Forest Service officials, large and small timber company owners, and several timber related associations.

On December 8, 1982, the Subcommittee on Productivity and Competition held an oversight hearing on the "Economic Problems Facing Small and Independent Businesses in the Forest Product Industry."

Senator Gorton, Chairman of the Subcommittee, and Senator Baucus expressed concern that the country's economic slump was having a disproportionate effect on small business.

Witnesses from several western states testified that due to high interest rates, low cash reserves, and the devastated housing market, the entire timber industry was severely threatened. Many instances were cited of timber related businesses being forced to close their doors because of their inability to survive in the economic climate.

Witnesses also were in agreement that timber relief legislation is needed in order to avoid imminent default of timber contracts, and industry concentration.

Michael Burrell, President of Burrell Lumber Company of Oregon, stated:

> The problem facing our industry today is really divided into two parts. The first part is due to many causes; generally, due to the collapse of the housing industry, purchasers of Government timber have curtailed operations to the point that a backlog of sold but uncut has increased. . . With this large volume under contract, and a home building industry that is in a continuing depression that is now three years in length, demand for our products is so low that even if the cost of this timber was at prices profitable at today's market, we still could not have sufficient markets to utilize the volume. . .
>
> The second part of our problem is that most of the board feet under contract is priced at levels far above the breakeven point on today's markets. Market prices for our products have declined from 25 to 50 percent during the life of the recession, and even today are not showing any definite signs of recovery or even giving us any real hope in the short term.

Arthur Harwood, of Harwood Products of California, said:

> We do not see any relief coming in the short term or the long term that would enable most small companies of our size to be able to survive and operate timber as it is bid today. . .
>
> Most big companies in our area have large resource bases behind them, so that they are able to water down these high timber sales. Most of them will survive because of it. What will happen is, most of the small companies are going to go down the tubes if some kind of relief is not forthcoming in the future. Really, most the large companies, although they will be pretty much bloodied up, are going to survive in some form. So what you will have is a much smaller percentage of the overall economic base in the forest industry. . .

The Small Business Committee will continue to search for ways to improve the lot of small timber companies in the 98th Congress.

## CHAPTER SIX: SMALL BUSINESS AND GOVERNMENT REGULATIONS

Over the past decade, Federal regulations and paperwork have proliferated at a dramatic rate at the same time that government red-tape and compliance costs have been steadily increasing. In fact, many estimate that the costs associated with government regulation now amount to more than one percent of the GNP.

As countless studies have pointed out, small businesses bear the greatest share of the government regulation and paperwork burden. A small firm has only limited resources and capacity to respond to regulatory requirements, and paperwork compliance often places a serious drain on capital and personnel. A recent study indicated that the cost of government regulations is approximately $3,600 per year for every small business in the country. The fact is that without in-house experts or the financial capability to hire outside assistance such as lawyers and accountants, small businesses are frequently ill-equipped to deal with the rigid Federal regulatory process.

This Committee has long been concerned with the effects of government regulation and paperwork on small business. Through hearings, legislative initiatives and intervention in specific agency rulemaking procedures, Committee Members have sought ways to reduce the regulatory burden for small firms.

With the passage of three major regulatory reform initiatives in 1980—the Regulatory Flexibility Act, the Equal Access to Justice Act, and the Paperwork Reduction Act—this Committee has focused its regulatory efforts on oversight during the 97th Congress.

### A. REGULATORY REFORM

Shortly after taking office, President Reagan announced a comprehensive program to reduce the costs of complying with Federal rules and paperwork. He immediately ordered a freeze on dozens of "midnight" regulations issued during the waning days of the previous Administration so that they could be reassessed from a cost-benefit standpoint.

The President also established a Presidential Task Force on Regulatory Relief. Chaired by Vice President George Bush, the Task Force is charged with the review of current and future regulations. The group also has been made responsible for seeking private sector input into the regulatory process.

However, the key elements of the Administration's regulatory reform package were embodied in Executive Order 12291. Among other things, the Order directed agencies to determine the most cost-effective approach for meeting any given regulatory objective and required Federal rulemakers to perform a regulatory impact analysis on each proposed rule. The Task Force on Regulatory Relief is responsible for overseeing agency compliance with the Executive Order.

While applauding most of the Administration's regulatory reform efforts, the Committee and its small business constituency have repeatedly emphasized the need for the Administration to enforce existing small business regulatory relief laws in an aggressive and fair manner.

In the Senate, a broad proposal for regulatory reform, S. 1080, was introduced on April 30, 1981, by Senator Laxalt and cosponsored by more than half of the Senate. The measure, which was adopted by the Senate on March 24, 1982, would improve rulemaking procedures by requiring agencies to weigh the costs of major rules against their benefits. The legislation would also reform the judicial, executive, and congressional review processes related to the promulgation of Federal regulations.

As co-sponsors of S. 1080, the Chairman and ranking Minority Member closely monitored its progress through the Congress. Committee Members Hatch, Baucus, Sasser, Levin, D'Amato, Hayakawa, Boschwitz, Dixon, and Huddleston were also co-sponsors of this legislation. Concerned that the Regulatory Flexibility Act would be folded into the broader objectives of the omnibus regulatory reform legislation, this Committee worked with the Senate Committee on the Judiciary to assure that regulatory flexibility was not relegated to a minor status.

In fact, during consideration of the legislation, Senator Nunn offered an amendment to S. 1080 to address the matter.

During the Senate Judiciary Committee's consideration of S. 1080, the regulatory reform legislation, that committee added additional provisions to the Administrative Procedures Act. In addition, the Committee redesignated the "old" Regulatory Flexibility Act provisions (previously chapter 6 of title 5, United States Code) as a subchapter of chapter 6.

The net effect of these provisions would have been to seriously impair, if not eliminate, the role and responsibility for the implementation of the Regulatory Flexibility Act which Congress imposed on the Chief Counsel for Advocacy.

Senator Nunn offered an amendment (No. 619) on October 28, 1981, that would retain the existing law relationships for the implementation of the Regulatory Flexibility Act. According to Senator Nunn:

> As the Ranking minority member of the Senate Small Business Committee, and as a member of the Governmental Affairs Committee, I do not believe that the Chief Counsel for Advocacy should be undercut in his statutory role in implementing the Regulatory Flexibility Act. Nor do I believe that the Judiciary Committee or the Governmental Affairs Committee intend this result. The Small Business community needs to have a responsible, and responsive, advocate for their views within the Executive branch in the development of regulatory policies.

The Nunn amendment was incorporated into a revised version of the legislation, and passed by the Senate.

Legislation similar to S. 1080 was not considered by the full House of Representatives in this Congress.

### B. THE REGULATORY FLEXIBILITY ACT

The Regulatory Flexibility Act (P.L. 96-354), was enacted on September 19, 1980, and became effective on January 1, 1981. Seen as a major small business legislative victory, the law makes substantive changes in the way Federal agencies issue regulations. Specifically, the law empowers rulemakers to fit regulatory and informational requirements to the scale of the business, organization or governmental entity subject to the rule. Further, the Act requires agencies that promulgate rules pursuant to section 533(b) of the Administrative Procedures Act to:

> Publish a semi-annual regulatory flexibility agenda that contains a brief description of every rule the agency expects to propose that may have a significant economic impact on a substantial number of small entities.
>
> Publish an Initial Regulatory Flexibility Analysis (IRFA) for each proposed rule that explains the reason for the rule, gives an estimate of the number of small entities it will affect, provides a description of the reporting and com-

pliance requirements anticipated, and offers a description of significant alternatives to the proposed rule.

Publish a Final Regulatory Analysis (FRFA) for each final rule that explains the need for the rule, gives a summary of issues raised during public comment and provides the reasons for rejection of significant alternatives.

For each rule that does not contain an IRFA, publish a certification stating that the proposed rule will not have a significant economic impact on a substantial number of small entities.

Assure that small entities are given an opportunity to participate in the rulemaking process.

Publish a plan for periodic review of rules issued, including all those in effect on January 1, 1981, by the agency in the Federal Register.

The law also specifies that SBA's Chief Counsel for Advocacy has the overall responsibility for monitoring agency compliance with the Act and authorizes the Counsel to appear as an amicus curiae in legal proceedings dealing with the Act.

Since its enactment, implementation of the Regulatory Flexibility Act has been a major concern of the small business community and of this Committee. Within weeks after assuming the Chairmanship, Senator Weicker wrote to President Reagan and asked him to personally oversee compliance with "the spirit and the letter of this major regulatory reform law."

In March 1982, the Committee became directly involved in oversight of the Act when Senators Weicker and Nunn sent a letter to Frank Swain, SBA's Chief Counsel for Advocacy, asking for a complete explanation of the Office of Advocacy's role in the *Thompson* v. *Watt* regulatory flexibility case.

Briefly, Mr. Stephen Thompson, a small business owner, challenged a Department of Interior rulemaking procedure under the Regulatory Flexibility Act in U.S. District Court. Thompson challenged the rule on the grounds the Department had failed to comply with the Act. The Committee and many segments of the small business community were concerned by the Chief Counsel's decision not to appear as an "amicus" in the case. That decision was later explained in writing to the Committee.

Other Committee Regulatory Flexibility oversight activities included a joint hearing with the Senate Judiciary Committee to analyze implementation of the law by Federal agencies. On August 12, 1982, the Small Business Subcommittee on Government Regulation and Paperwork, chaired by Senator Hatch, received testimony from the Chief Counsel for Advocacy, small business representatives, and legal experts on how well the law is working. Generally, witnesses agreed that the regulatory burden on business had been reduced during the last year, but declined to attribute it directly to the Regulatory Flexibility Act.

During the hearing, the Subcommittee also considered S. 2170, a bill introduced by Senator Dodd, to extend the provisions of the Regulatory Flexibility Act to the Department of Defense and to the Internal Revenue Service. Currently, both agencies claim they are exempt from the Regulatory Flexibility Act because they do not promulgate rules pursuant to section 533(b) of the Administrative Procedures Act.

Members of the small business community testified in support of the Dodd proposal because they maintained it would open up the rulemaking process at two agencies that heavily regulate small firms. They argued that S. 2170 is reasonable because it applies only to DOD or IRS rules published for public comment. Internal policy decisions and regulations not published in the Federal Register for public comment would still be exempted from the Regulatory Flexibility Act coverage.

At the hearing, the Defense Department witness opposed S. 2170. As with most other agencies originally affected by the Regulatory Flexibility Act, DOD protested that compliance with the law would be too time-consuming, too costly, too burdensome, and that it could jeopardize the national defense. No further legislative action was taken on S. 2170 in the 97th Congress.

### C. IRS EXEMPTION FROM THE PAPERWORK REDUCTION ACT

The Paperwork Reduction Act, passed in December 1980, requires Federal agencies to perform a cost-effectiveness check on all paperwork requirements imposed on the public, provides a mechanism to eliminate duplicative, needless, or burdensome Federal forms, and states that the public need not comply with Federal forms that have not been appropriately cleared by OMB.

The small business community strongly favored passage of the Paperwork Reduction Act, and in fact, counted it as one of its major victories in 1980. This Committee held a number of hearings on the need to reduce the Federal paperwork burden during previous Congresses, and strongly supported passage of the final version of the Act in 1980.

During 1982, the Chairman and several Committee Members became alarmed by a Senate Finance Committee proposal to exempt the Internal Revenue Service (IRS) from the law. Section 202 of the Taxpayer Compliance Improvement Act (S. 2198) proposed to significantly weaken the Paperwork Reduction Act by eliminating OMB's review of IRS paperwork and reporting requirements.

In a letter to the Senate Finance Committee, Senator Weicker and 12 other Committee members pointed out that the IRS alone is responsible for more than half of the paperwork requirements imposed on the small business community. The letter cited the potential adverse effect of Section 202 on the small business sector of the economy and called on the Finance Committee to delete the IRS exemption from S. 2198.

During Finance Committee markup of the Taxpayer Compliance Act, the proposal to exempt IRS from the requirements of the Paperwork Reduction Act was dropped, a move this Committee considered both prudent and in the best interests of the small business community. The remaining provisions of S. 2198 were later incorporated into the Tax Equity and Fiscal Responsibility Act.

### D. THE IRS AND REGULATION 385

On July 7, 1982, small businesses won a significant victory when the Treasury Department agreed to postpone and reconsider debt/equity regulations proposed under Section 385 of the Internal Revenue Code.

The Treasury's concession marked the end of an extensive effort by Members of the Small Business Committee and its National Advisory Council to stop the proposed regulations from being implemented.

As written, the regulations would have allowed certain financial transactions which had been treated as corporate debt to be classified as non-deductible dividends, and the repayment of principle to be treated as ordinary income, resulting in a tax liability for the small business owner.

The regulations were raised as a major concern to small business owners during the April 22, 1982, meeting of the Small Business Committee's National Advisory Council. In a presentation to Committee Senators, Council members called the proposed 385 regulations "overly complex, impractical and inhibiting," and said they would impede small businesses from borrowing money for capital expansion.

At the close of the meeting, Council members passed the following resolution, which asked for outright repeal of Section 385, as well as for joint hearings on the subject by the Small Business and Finance Committees of the Senate.

The National Advisory Council of the Senate Committee on Small Business finds that:

> Whereas the Department of the Treasury delayed in issuing proposed regulations which would implement Section 385 of the Internal Revenue Code for 11 years;
>
> Whereas the Department of the Treasury has now issued over a two and one-half year period three successive drafts of regulations to implement Section 385 of the Internal Revenue Code, each of which attempts to define the terms "debt" and "equity" for federal income tax purposes;
>
> Whereas the Department of the Treasury's latest draft regulations released on January 5, 1982 still create arbitrary and capricious situations that will (1) equitize the interest paid on debt instruments, thereby precluding such debt from being a deductible expense by the small business corporate payor, and (2) cause the repaid principal of the debt instrument to be treated as a dividend, thereby making such principal ordinary income for tax purposes;
>
> Whereas the Department of the Treasury's January 5, 1982 proposed regulations are 40 pages in length and contain a dazzling array of confusing and difficult to comprehend rules, sub-rules, exceptions, qualifications, definitions, safe harbors, references to multiple other sections of the Internal Revenue Code, and rules convenient only to the Department of the Treasury and the Internal Revenue Service;

> Whereas the proposed regulations will undeniably impede the capital formation process of young, growing businesses and mature, financially troubled independent businesses; and
>
> Whereas the flow of capital to these businesses is essential to the renewed vitality of the American economy;
>
> Now, therefore, be it
>
> *Resolved,* That there be an immediate introduction of legislation to repeal Section 385 of the Internal Revenue Code to be followed shortly thereafter by joint Senate Small Business and Senate Finance Committee hearings to examine this critically important issue and consider favorably reporting the measure introduced.

On June 8, 1982, Senators Weicker, Chafee and a coalition of Senators, including Small Business Committee Members Baucus, Boschwitz, D'Amato, Nunn, Sasser, Dixon, Rudman, Huddleston and Gorton, introduced S. 2610, a bill to delay the implementation of the section 385 regulations, which were then due to go into effect on July 1, 1982.

In a statement on the Senate floor, Senator Weicker called the regulation "convoluted, conflicting and counterproductive," and noted that they had been opposed by small business groups and organizations across the country.

Bill sponsors argued that the proposed regulations violated the congressional intent of Section 385 by imposing rigid formulas and definite rules rather than general guidelines to be evaluated in individual cases. Under the legislation, any revised version of the debt-equity proposal would have to undergo a 180-day congressional review before being put into effect by the Treasury.

On July 7, 1982, faced with widespread opposition to the proposed regulations, the Treasury Department announced it would suspend implementation of the proposal until after March 31, 1983. In the interim, Treasury officials indicated they would review and possibly modify the Section 385 regulations.

The Committee will continue to monitor developments in the debt/equity area, and will carefully scrutinize any proposals offered by the Treasury Department that would revise existing debt/equity definitions.

### E. EMPLOYEE RETIREMENT INCOME SECURITY ACT

On August 14, 1981, Senator Gorton, Chairman of the Subcommittee on Productivity and Competition, held a hearing in Seattle, Washington, to review the effects of the Employee Retirement Income Security Act (ERISA) and the Multiemployer Pension Plan Reform Act of 1978 (MPPRA) on small businesses.

In light of questions raised about the continued viability of the Social Security System, Senator Gorton expressed concern that more reliance is likely to be placed on private pension plans and individual retirement savings as a source of retirement income.

> It is estimated that by the year 2000, there will be 31.8 million over the age of 65 in the United States, Gorton said. Adequate economic incentives to encourage the

> growth of private pension plans or individual retirement savings are crucial to the future viability of the Nation's retirement systems.

Passage of ERISA, Gorton noted, was designed to give employees in private pension programs protection, and to make sure that they were receiving the benefits promised them.

At the same time, however, Gorton said it is equally important that the regulations and requirements placed on firms that operate pension plans not be so restrictive as to discourage program creation or expansion.

Gorton said he was particularly disturbed about the impact of regulations on small firms, which are "least able to cope" with Government redtape.

"In our quest to repair social security, we must be careful not to stifle this important sector of our economy because we must depend on small businesses to play a major role in the future growth of employment as well as private businesses," the Senator commented at the start of the August 14 hearing.

Testimony at the hearing from small business owners and pension fund attorneys confirmed Senator Gorton's fears, with witnesses complaining of "mountains of paperwork," "hopelessly intertwined government restrictions" and "impending economic doom" for many unsuspecting small firms.

Bruce McKenzie, a Seattle attorney, said the rules issued under ERISA are "a classic example of legislative and regulatory overkill, with rigid requirements on virtually every detail of day-to-day trust fund operation." McKenzie called the paperwork "simply staggering."

Officials with two trucking companies, Thomas E. Lovejoy, Chief Executive Officer of Puget Sound Freight Lines, and Harmon Leonard, President of Acme Inner-City Freight Lines of Seattle, said that the enactment of MPPRA, along with the deregulation of the trucking industry, had combined to create disaster for firms such as theirs.

According to Lovejoy:

> The combination of these two well-intentioned laws on the trucking industry represents a ticking time bomb that will contribute to the ultimate destruction of most small businesses that were participants in the motor carrier industry prior to trucking deregulation.

Leonard, who said passage of MPPRA "dealt the death blow" to the trucking industry, told the Subcommittee that "under the terms of this bill, we have what amounts to an unsalable business with the liabilities amounting to more than the net worth. What is the incentive for the small operator to invest years of capital and effort in a business, only to have it all wiped out by the stroke of a pen in Washington?"

Vern Sims, president of Vern Sims Ford in Sedro Woolley, Washington, said his experiences in trying to get an exemption from prohibited transactions granted by the Department of Labor resulted in a "horror show" of delays, redtape and regulatory requirements that stretched over 6 years.

As a result of the government's inaction on his request, Sims said his firm has been placed in the position of "making investments, that while they pay an excellent return and have provided to be absolutely safe and in the interest of the plan's participants, may have been in violation of certain sections of ERISA." The penalty for such violation, Sims noted, could be the imposition of a five-percent excise tax on him personally.

"All we have asked for in the marketplace is a fair shake, an answer from our government * * * justifiable equality is about all I am asking," Sims said.

At the close of the hearings, Gorton said it was clear that some aspects of the ERISA and MPPRA laws were "obviously counterproductive." He indicated to the witnesses that he will encourage corrective actions by the Congress.

## CHAPTER SEVEN: SMALL BUSINESS AND EXPORTING

While exporting among the other countries of the world has grown by leaps and bounds in the past few years, figures show that export growth in the United States has been largely negligible. In fact, roughly 80 percent of the total export market in this country is controlled by only 200 firms. The Department of Commerce estimates that small business currently accounts for no more than 10 percent of total annual U.S. exports, despite the fact that at least 20,000 small firms in this country have the potential to competitively and profitably market their products overseas. Clearly then, one of the greatest opportunities for reversing the "no-growth" trend in our Nation's exporting lies with tapping that potential and increasing the number of small business exporters.

The Senate Small Business Committee has been vitally concerned about the extent of small business participation in exporting, and has carefully reviewed those Federal policies and programs which have acted as an assistance or a barrier to increasing small business export opportunities. In 1979, the Senate Small Business Committee held four days of hearings on matters related to export policies and small business participation in international markets. In April 1980, Committee hearings focused on the Carter Administration's proposed multinational trade agreements to open foreign government contracts for competitive bids, and their potential beneficial effect on small business. In September of that year, the Committee continued its investigation of small business participation in international marketing, concentrating on Government export promotion efforts.

In addition, the 1980 White House Conference on Small Business devoted one of its work sessions specifically to the appropriate role of small business in exporting, and offered five recommendations to address this issue.

As a result of these activities, the Committee identified a number of crucial factors that have precluded greater small business participation in international commerce. It became clear through testimony that for those small businesses interested in exporting, financial, procedural and other barriers had limited their ability to compete overseas.

### A. THE EXPORT EXPANSION ACT/EXPORT PROMOTION CENTERS

In an effort to address some of these problems, the Committee in 1980 developed the Small Business Export Expansion Act. This bill, which was subsequently enacted into law as Public Law 96–481:

Established within the Small Business Administration an Office of International Trade, and mandated the placement of export development specialists in each of the agency's regional offices;

Established an export revolving line of credit loan guarantee program in the Small Business Administration to provide pre-export financing assistance for eligible small businesses; and

Authorized the Department of Commerce to make matching grants to small businesses and other organizations to establish small business export development programs.

The Department of Commerce committed $1.8 million in fiscal year 1982 to fund, on a 50–50 matching basis, qualified grant applications, up to a maximum of $150,000 per applicant. The legislation specified that at lease one export development program be funded in each of the Department's regional offices. As a requirement for grant eligibility, program applicants were required to demonstrate, among other things, an ability to counsel small businesses interested in exporting; provide market analyses of the export potential of a small business; and develop contacts with potential foreign customers and distributors for small firms and their products.

Sixteen grant awards were made for FY 1982. Ten of these were made to the highest ranked application from each of the ten Department of Commerce regions; 6 additional grants were awarded to the next six highest ranked applications. Grants were made to the following entities:

| Region | Amount | Applicant's name |
|---|---|---|
| I | $150,000 | Northeast Governor's Conference, Boston. |
| II | 150,000 | World Trade Institute, New York City. |
| III | 150,000 | Maryland Dept. of E&C Development, Baltimore, Md. |
| IV | 35,000 | Marketing International, Greensboro, N.C. |
| V | 111,208 | Michigan Department of Commerce, Detroit. |
| VI | 85,000 | Ark. Industrial Development Commission, Little Rock, Ark. |
| VII | 73,200 | Nebraska Department of Economic Development Omaha, Nebr. |
| VIII | 150,000 | Inter-Continental Business Association, Denver, Colo. |
| IX | 81,933 | General Resources, San Francisco. |
| X | 87,000 | State of Washington, Seattle, Wash. |
| X | 109,877 | State of Oregon, Dept. of Economic Development, Portland, Oreg. |
| III | 150,000 | City of Philadelphia, Philadelphia. |
| IX | 150,000 | State of Arizona, Phoenix, Ariz. |
| V | 146,500 | Wisconsin Department of Development, Milwaukee, Wisc. |
| IX | 150,000 | San Diego State University, Los Angeles. |
| V | 150,000 | State of Ohio, Cinicinnati, Ohio. |

### B. THE SMALL BUSINESS COMMITTEE EXPORT REPORT

In an effort to focus further Congressional attention on the need to encourage exporting by small business, in the 97th Congress, the Senate Small Business Committee established an Export Promotion and Market Development Subcommittee, chaired by Senator Rudy Boschwitz.

Under the direction of Senators Boschwitz, Weicker and Huddleston, the Export Subcommittee surveyed approximately 6,300 potential and practicing small business exporters. Most of the firms surveyed were selected from the Small Business Administration's Procurement Automated Source System (PASS). Although the PASS system was not established primarily to identify small business exporters, it does contain the most readily accessible list of small businesses which do export or have expressed an interest in exporting.

The two-fold purpose of the Subcommittee's survey was to ascertain what obstacles to exporting small businesses actually face, as well as those factors they perceive as impediments to their exporting activity, and, to solicit suggestions as to what steps Congress could and should take to address the barriers to increased small business participation in exporting.

The survey findings were published in a Committee report entitled "Survey of Findings on Obstacles to Exporting Faced by Small Businesses." A summary of the major findings of that survey follows.

### *Survey findings*

Survey respondents were asked to identify the major obstacles they faced in exporting—excluding disincentives addressed by legislation establishing Exporting Trading Companies and revising the Foreign Corrupt Practices Act. They were also asked for suggestions as to what the government should do to stimulate small business exporting.

### *Obstacles to exporting*

Four general categories accounted for over 70 percent of the obstacles identified. These are: 1. Lack of information; 2. Regulations; 3. Expenses incurred; and 4. Financing problems.

### *Lack of information*

The lack of information essential to exporting was found to be the most significant obstacle. Exporters and potential exporters said that they lacked information about opportunities in foreign markets and that they were unable to identify foreign customers and representatives. Additional problems cited in this category included lack of information on foreign regulations, difficulty in obtaining information to fill orders, a lack of information on government services available, and a lack of financing information.

### *Regulations*

The second most noted obstacle to exporting involved the time, expense, and paperwork required to comply with foreign and U.S. regulations. Respondents specifically cited the complexity and confusion associated with foreign regulations, a lack of knowledge about what paperwork was involved or how much of it was required, and the delay caused by complying with foreign and domestic procedural requirements and regulations.

## *Expenses incurred*

The expenses listed as obstacles to exporting broke down into two basic groups—those related solely to exporting (foreign tariffs, broker/representative fees, and costs for foreign trade fairs); and those normally associated with producing and selling a product anywhere (transportation/shipping expenses, promotion/marketing expenses, and administrative and insurance expenses). For some business owners, the combination of normal operating expenses and export-related expenses was enough to make the cost of exporting too high a price to pay. The high cost of participating in foreign trade shows and the lack of financial support for participants by the U.S. government were also cited as problems.

## *Financing problems*

Financing problems fell into two categories: over half of the respondents cited practical, everyday business problems such as getting paid, obtaining credit, and dealing with banking inefficiencies. The second category consisted of problems related more to taking on a new venture, such as inadequate captial, the high cost of money, and the lack of tax incentives.

## *Other obstacles to exporting*

Competition, both foreign and domestic, was also cited as an obstacle to exporting. The overwhelming majority of these responses said that competition from foreign firms and subsidies by foreign governments gave overseas firms an advantage. Others cited the lower labor costs abroad as a factor giving foreign companies the competitive edge.

Respondents also indicated that a lack of experience or a lack of manpower inhibited their ability to export. Others stated that their operation was ill-suited to exporting because of the nature of their product or their limited production capacity.

The lack of assistance from U.S. government agencies in this country and abroad was another general area of concern. The responses ranged from a perceived lack of coordination among agencies regarding export licensing requirements to the perception that agency personnel did not want to accept responsibility for decisions in general. A number of respondents cited staff problems with government agencies.

Communications problems were also noted. Chief among these was the language barrier. In addition, cultural differences and time delays were cited as impediments to communication.

Finally, general economic conditions such as the strong U.S., dollar, the fluctuation of the U.S. dollar, and the economic recession abroad were identified as obstacles.

## *Suggested Government action*

Five general categories accounted for over 80 percent of suggested governmental actions to remove barriers to exporting. These were: 1. Provide More Financing; 2. Provide Exporting Information; 3. Provide Outreach Programs; 4. Simplify Regulations; and 5. Improve Existing Federal Services.

### *Financing*

The leading recommendation for government action to address the problems of exporting was that financial assistance be provided. Respondents suggested that tax incentives or subsidies be instituted for exporters, that the government provide better credit/risk insurance programs, that it underwrite the cost of participating in trade fairs, that it guarantee payments to U.S. sellers, and that it provide low interest loans.

### *Exporting information*

The chief concern expressed was that the government provide more assistance in locating foreign customers. Respondents also recommended that the government provide them with more free and timely information, that it provide them with names of foreign importers and that it provide them with information concerning foreign export regulations.

### *Outreach programs*

Recommendations for outreach programs included suggestions that the government hold seminars on how to export, increase the number of local assistance contracts, help to promote and market American products, and encourage the operation of export trading companies.

### *Simplifications of regulations*

The complexity of existing regulations was a recurring theme. Respondents repeatedly suggested that regulations be revised and simplified, and that paperwork requirements be reduced. The director of a manufacturing company in Cleveland, Ohio, summed up the views of many:

> As Thoreau said: "simplify, simplify, simplify." Make programs simple, not more difficult than marketing domestically.

### *Improvement of existing Federal services*

Most of the suggestions in this category were a general endorsement for continuing and improving existing services of the Department of Commerce, the Small Business Administration, etc. A number of respondents also cited the need for greater responsiveness by U.S. embassies and consulates. Other suggested easier access to EX-IM Bank loan programs to make small businesses more competitive with foreign suppliers.

### *Other recommendations for Government actions*

Other recommendations for Federal actions were that the government establish a reciprocal trading environment, that it get its economic house in order, and that it take actions to improve communications.

## C. SMALL BUSINESS COMMITTEE EXPORT HEARINGS

Senator Boschwitz chaired a hearing of the Small Business Export Promotion and Market Development Subcommittee on

August 19, 1982 in conjunction with the release of the Committee's export report. Other Senators actively involved in the hearing were Senators Huddleston and Dixon.

Testimony was heard from a panel of small businessmen, from the Assistant Secretary for Trade Development, International Trade Administration, Department of Commerce, from the Acting Deputy Administrator, Small Business Administration, and from the Deputy Commissioner of Commerce, Division of International Commerce, New York State Department of Commerce.

One of the small businessmen testifying cited the need for more U.S. trade shows and for the dissemination of more information about these shows to foreign participants. Another discussed problems with U.S. Consumer Products Safety Commission regulations. Still another expressed concern about delays in the issuance of export licenses:

> A simplification for obtaining export licenses is an absolutely necessity in order to encourage small businesses to engage in international trade and also to cut the present unnecessary expenditures to a minimum. An acceptable procedure for all parties involved would be the qualification of each product for export licences on a one time basis for each country instead of the present procedure which requires application each time for the same product.

William H. Morris, the Assistant Secretary for Trade Development, International Trade Administration, talked about the new "Basic Guide to Exporting" released by the Commerce Department. This publication, he said, is a document "to take a businessman step-by-step through all the aspects of exporting and to refer him to all the sources and resources he might need to be successful in the undertaking."

Mr. Morris also told the Committee about changes by the Commerce Department in the structure of the U.S. commercial and foreign commercial services. These operations have now been combined under a single Director-General. Morris explained that:

> We have moved more people out of Washington and into the field to spread the word and provide assistance, with increased attention to small and medium-sized businesses, and I might add we have reemphasized the business orientation of these operations with increased recruitment from the private sector and specific business training for every one of our commercial officers.

Peter Terpeluk, Acting Deputy Administrator, Small Business Administration, said the SBA planned to assist small businesses in exporting by putting them in touch with "private sector international trade providers."

Mr. Terpeluk also told the Committee about the Small Business Administration's export revolving line of credit-loan guarantee program established pursuant to P.L. 96–481. As implemented, the program allows small business exporters to obtain up to $500,000 (or 90 percent of the amount) through SBA loan guarantees for a revolving line of credit to finance the firm's working capital needs. In addition, he said SBA was using the Service Corps of Retired Executives (SCORE) and the Active Corps of Executives (ACE) to assist small businesses in entering the export market.

Both Mr. Morris and Mr. Terpeluk said they thought enactment of the export trading company bill (now P.L. 97-290) would greatly assist small businesses.

Alan Parter, Deputy Commissioner of Commerce of New York State, testified about that state's recently created export financing facility. According to Parter, the state's export bank would provide the following services:

> First, a medium-term discount loan program that would offer fixed-rate financing to qualifying New York companies unable to obtain financing elsewhere; secondly, a supplemental export insurance program that would help smaller companies obtain assurance of payment on their receivables; third, a short and medium-term guarantee program that would ensure the recourse worthiness of marginal exporters and help them secure export financing.

He also testified that according to exporters' projections, such a bank could support more than $1 billion in export sales during the initial 5 years of operation. Moreover, that level of activity would translate into as many as 50,000 jobs.

On October 21, 1982, Senator Slade Gorton chaired a small business export hearing in Spokane, Washington. The purpose of the hearing was to solicit testimony concerning obstacles to exporting faced by small businesses. Witnesses included small business exporters of agricultural and manufactured goods as well as spokesmen for state and Federal agencies responsible for encouraging exporting.

Mr. William Buckles, President of Centron Limited, Selah, Washington discussed the problems his new business encountered:

> As a new small business, the obstacles and hurdles related to the complexity of exporting are numerous. They include the obvious, such as the time and expense developing these markets as well as the rates involved.
>
> Hurdles have been intensified, I think for us by the lack of a comprehensive policy toward exporting of the Federal Government. As I say that, I think as a very small business these hurdles come as a result of a reluctance of Federal agencies to deal with companies resulting from frustrations and difficulties that have been experienced in the past with new companies trying to get into exporting. It is a complex business.

A spokesman from the International Trade Administration told the Committee:

> Since each $1 billion in exports represents about 31,000 United States jobs, it's easy to see what even a small increase in exports could mean to our economy. A 10-percent increase in last years exports of manufactured goods would have been $15.4 billion, almost half of the 1981 trade deficit, and we would have created almost 500,000 new jobs. Small firms, however, tend to regard selling overseas as a

> riddle and are not prepared to undertake the additional costs and risks.

It was the general consensus among all who testified at the Spokane hearing that access to exporting information was the largest deterrent to businesses entering into, or continuing an active exporting market.

In the 98th Congress, the Small Business Committee will continue to examine how best to assist small businesses to increase their export potential.

## CHAPTER EIGHT: SMALL BUSINESS AND DEVELOPMENT IN URBAN AREAS

Recent studies of job creation in our economy have reconfirmed the importance of small businesses to our cities and local communities, and to our national economy as a whole. MIT Professor David Birch's pioneering 1979 study, for example, concluded that over 60 percent of the new jobs in our country are created by new small businesses. A subsequent study by Birch of employment growth in selected metropolitan areas has revealed that over 80 percent of net new jobs come from small businesses. Professor Birch noted:

> Whatever the cause, it is clear from the figures that the only source of net new jobs in older areas is in small businesses * * *.

It is obvious from Birch's statements and others that for any plan to revitalize or redevelop distressed communities to succeed, it must have as a central component the development of a vibrant small business sector.

### A. ENTERPRISE ZONES

At the center of the debate in the 97th Congress on how to cure some of the problems of distressed urban areas has been the concept of "Enterprise Zones." Originally conceived of in England in the late 1970's, the concept of "enterprise zones" was to establish geographically defined areas in English cities where there would be no taxes or regulations. The purpose of the zones would be to stimulate private business investment and job creation. Legislation authorizing enterprise zones was enacted by Parliament in 1980.

Dr. Stuart Butler, of the Heritage Foundation, introduced the idea of enterprise zones in this country, and has been one of its principal advocates. His original enterprise zones concept is based on the premise that taxes and government regulations are major deterrents to new small business development in blighted areas, but that, with the incentive of a tax-free, regulation-free environment, small businesses would develop in those areas, thus creating jobs and giving a boost to local economies in those previously depressed regions. As Butler states:

> The enterprise zone rests on the assumption that within even highly blighted areas of our cities there is enormous potential for economic development. It is built on the idea of encouraging the potential of these inner city neighbor-

> hoods to bring into life the factors of production that are dormant.

The cornerstone of Butler's concept of enterprise zones is its emphasis on new small firms. Therefore, the key to fashioning a valid program rests on removing the disincentives to small business formation in distressed areas.

Several legislative proposals have been introduced in the Congress to establish enterprise zones. The first bill to attract attention in the 96th Congress was the Urban Jobs and Enterprise Zone Act (S. 2823, H.R. 7863), introduced in the Senate by Senators Boschwitz and Chafee and in the House of Representatives by Congressmen Kemp and Garcia. A modified version of that bill was reintroduced in June 1981. In his campaign and also in his first State of the Union Address, President Reagan endorsed the concept of enterprise zones. On March 23, 1982, the President submitted his proposal to Congress.

The intent of the Administration's proposal was much the same as Butler's original concept. In order to create an environment in depressed areas in which development could be created and expanded, businesses would be relieved of taxes and regulations. In this way, the Administration would hope to create jobs for disadvantaged workers and to revitalize and redevelop the geographic zones. Under the proposal, local and state governments would be required to make contributions to the zones. The major features of the Administration's Federal tax incentives were:

> A nonrefundable investment tax credit for capital investments in an Enterprise Zone. For personal property, such as machinery or equipment, this credit would be 3 or 5 percent. For the construction or rehabilitation of commercial, industry or rental housing structures within a zone, the credit would be 10 percent.
>
> A nonrefundable, 10 percent income tax credit to employers for payroll paid to qualified zone employees in excess of payroll paid to such employees in the year prior to zone designation.
>
> A nonrefundable, 50 percent income tax credit to employers for wages paid to zone employees who were disadvantaged individuals when hired.
>
> A nonrefundable, 5 percent income credit to qualified zone employees for wages earned in zone employment.
>
> The elimination of capital gains taxes within the zones.
>
> The designation of suitable Enterprise Zone areas as Foreign Trade Zones, providing relief from tariffs and import duties.
>
> The continued availability of Industrial Development Bonds to small businesses in Enterprise Zones even if the availability of such bonds is terminated elsewhere.
>
> Any Enterprise Zone firm would be allowed an operating loss carryover for the life of the zone in which it is located, or 15 years, whichever is longer.
>
> Any Enterprise Zone firm would be allowed a carryover of any unused employment tax credits for the life of the zone in which it is located, or 15 years, whichever is longer.

Because of the crucial importance of small business to the success of any enterprise zone proposal, the Committee held a series of hearings to examine the concept in detail. On February 25, 1982, Senator Boschwitz chaired the Committee's first hearing on the concept of enterprise zones. Subsequent hearings were held by Senator Dixon in Chicago, by Senator Hayakawa in Oakland, California; and again by Senator Boschwitz in St. Paul, Minnesota.

The principle objective of these hearings was to identify the primary factors that would influence and encourage small business investment and development in enterprise zones. The Committee heard testimony from a broad spectrum of participants concerned about local economic development and experts on small business development. Those witnesses included elected officials, local and state government administrators, small business advisors and consultants, representatives of investment institutions, and representatives of community based organizations.

The witnesses were asked to comment on the central premise of the enterprise zone concept; i.e., that by reducing taxes and government regulations, businesses would locate to distressed areas, thereby producing jobs for residents and aiding the redevelopment and revitalization of the area. The witnesses were also asked to suggest ways in which the Federal government could promote small business development in enterprise zones.

### *Tax incentives*

While most of the witnesses did not necessarily accept the premise that excessive taxes and regulations were major deterrents to business formation in distressed areas, they did generally express support for the concept of enterprise zones as a complement to existing federal programs to aid local economic development. Although most viewed the program as presenting opportunities to be creative and to experiment, they hastened to point out that the concept should not be viewed as a panacea to the probems of blighted urban areas. As Maynard Wishner, President of Walter E. Heller & Company stated at the Chicago hearing:

> The challenge to Congress and the Administration is to do the best that can be done in framing a bill which is rooted in our current political reality and provides all the incentives which can responsibly be developed and applied. The zones to be designated and the people to occupy them have need for more than the development of indigenous businesses. As we embark on this trial of something new, we ought not to tell ourselves or tell our citizens that we have in one stroke at last found a solution to the problems of our inner cities. Perhaps enterprise zones can make a contribution, but we ought to not raise expectations to a level that will not be achieved or rest from the responsibility to continue to seek other means to break the pockets of need, decay, and disillusionment for which our country continues to pay a high price.

And Mayor Lionel Wilson of Oakland, California, cautioned:

> To make enterprise zones attractive for development, funds and programs are needed to provide public infra-

> structure, transportation, environmental improvements, marketing promotion, and housing.
>
> You cannot look to cities to provide those types of improvements.
>
> The financial capacity is not there, and the financial situation at the State level is rapidly deteriorating.
>
> The Federal Government must remain a resource for carefully targeted funds if enterprise zones are to be effective.

Mayor Wilson said that existing Federal programs which have been useful and should be retained as part of an overall economic development program, include the Urban Development Action Grant (UDAG) program, tax-exempt industrial development bonds and SBA's 502/503 and Section 7(a) loan programs. His recommendations were reinforced by several other witnesses who supported the Mayor's point that more than tax-abatement is necessary to create the kind of environment needed to foster development.

Professor Birch of MIT said:

> My own discussions with small businesses and small business groups suggests that what a young, growing, job-creating business needs most from the world around it, in order of priority, are: (1) A "civil" environment; (2) help in raising capital; and (3) more favorable tax treatment.
>
> Of these three, a civil environment is by far the most important. Starting a small business is hard enough without having to worry about muggings in the parking lot, availability of insurance, vandalism, and red-lining by banks. Favorable tax treatment, in contrast, is a distant third because so few young, expanding businesses make any taxable profit at all in their first few years.

While several witnesses stressed that taxes were not the most important factor which would influence the success of the concept, taxes, of course, are a significant consideration. Many felt a different mix of tax incentives than those proposed by the Administration would be required in order to achieve the articulated goals and objectives of the enterprise zones. The hearings made it clear that a very complex set of factors influence a business' locational decision. In order to insure small business participation in enterprise zones, however, some of the needs which must be addressed include providing low cost capital, skilled labor, business management assistance and community support.

### *Capital needs*

At each of the Committee hearings, witnesses stressed that in order to promote new start-up businesses and to expand existing businesses in an enterprise zone, the most crucial factor was to provide for affordable capital. In commenting on pending legislative proposals, witnesses often cited the lack of a provision for seed capital or expansion capital as the major shortcoming of those proposals.

There are very obvious costs incurred in starting any business. Depending on the industry, the entrepreneur typically needs money to purchase or rent a facility and equipment, to pay the utility or gas services costs of operating his plant, to purchase and stock inventory, and to pay his employees. As witnesses pointed out, providing the business with a reduction in income taxes does nothing to help the entrepreneur meet these initial costs of establishing and operating a business. Maynard Wishner of the Heller Corporation stated:

> * * * tax benefits to the operating company itself suffers from the fact that newly formed businesses are not wallowing in profits which need to be sheltered to help finance additional growth.

For most start-up companies the major source of capital has been from personal savings, family and friends. According to Jack Wilson, Director of Special Projects for the National Federation of Independent Business (NFIB), a survey of their members revealed:

> Sixty percent have personal resources as their principal source of capitalization, just over one of five have lending institutions as theirs, although we have no idea how many unidentified second mortgages are involved; friends and relatives account for another 1 of 10; government and venture capital firms combined constitute a bare 1 percent.

Where debt financing from lending institutions has been available, often it has been little more than an extension of the personal resources of entrepreneurs and generally is viewed as insufficient to meet businesses' needs. Likewise, for existing businesses which might want to expand or locate a branch facility in an enterprise zone, the availability of low-cost, affordable, working and expansion capital was identified as a major problem.

While many witnesses viewed the lack of such a provision in the legislation as a major shortcoming, several witnesses suggested mechanisms to incorporate a capital investment tax incentive into existing proposals. Considerable testimony supported the conclusion that an investment tax credit to investors in zone businesses was needed. One of the witnesses commented that providing such a provision would be a way to balance some of the unintended discriminatory effects of existing tax rules which inhibit the attraction and retention of capital by smaller businesses, particularly start-up businesses.

Of particular note was a recommendation made by several witnesses that a special kind of enterprise zone stock might be established. The first witness to make this specific proposal was Paul Pryde, President of Janus Associatess in Washington, D.C. Mr. Pryde recommended that "purchasers of Section 1244 (Internal Revenue Code) stock issued by enterprise zone companies should be permitted an immediate ordinary loss deduction in the amount of the investment." Alternatively, Pryde suggested that a new kind of stock, the Small Business Participating Debenture, might be created for enterprise zones. Investors in the SBPD, like the 1244 stock, would be entitled to a deduction in the amount of their investment.

The identical suggestion was made by Mike Smith, a Duluth, Minnesota attorney with considerable experience working with small businesses. As Smith, Pryde, and others stressed, the key feature allowing taxpayers to realize immediate tax savings would tip the balance and encourage many small investors to invest in enterprise zone firms.

*Management and technical assistance*

Another barrier to business formation critical to the success of enterprise zones and the establishment of new businesses is the ability and the skills of the entrepreneur. While capital, labor, and markets are all important, the difference between a successful venture and a failure often rest mainly on the management abilities of the chief executive. In order for the enterprise zone to meet its greatest challenge and reach its fullest potential, particularly in making business ownership opportunities for zone residents, management and technical assistance was considered by many to be as important as providing for a safe atmosphere or providing for start-up capital. This point was made emphatically by William Lytle, President of the minority-owned Waterbury Pen Corporation of Bridgeport, Connecticut:

> In any business enterprise, it is the management that defines the direction for the business and brings to it whatever resources are necessary to enable it to conduct its operation properly. It is the capability of that management that most influences the potential success or failure of the business enterprise.
>
> In developing businesses in economically depressed urban areas, the business manager has the additional task of dealing with the problems of personnel development and crime associated with operating in these locations. These additional burdens have discouraged many white business managers from establishing and expanding their business operations in these areas.
>
> The attempts to develop businesses owned by the residents in depressed urban areas have not always been undertaken by those people with the necessary business management skills that would enable them to make their business sucessful. The majority of the people who reside in these areas have had very little opportunity to be exposed to business management. Many times the extent of their management experience is the supervision of their fellow direct labor employees.
>
> Most minority managers that have developed the skills necessary to operate a small business have developed them inside of some other business enterprise. Once achieving these skills and the rewards that go with them, they are reluctant to leave these places of employment to venture out on their own and undertake the development of small businesses. Substantial inducement must be provided to encourage these people to leave their hard-won positions of management to undertake development of a business. These inducements could also encourage white entrepreneurs to look more favorably on depressed urban areas to establish and expand their enterprises.

> The small businessman has to operate in many different areas of his business in order to make sure it functions properly. Since his operation is not large enough to employ a number of specialists in each of the basic disciplines of his business, he must be functional in general management, sales, finance, operations, personnel, and purchasing. As he does not have time to function in all of these areas effectively, he typically gravitates to those areas he enjoys or that have obvious problems, and provides very little time for other functions.

*Availability of labor supply*

The availability of a trained labor supply and the costs of labor are often cited among the factors which influence a business' locational decision. Recognizing that a central focus and objective of enterprise zones is to provide jobs for residents of areas with high unemployment, witnesses stated some of their concerns particularly with respect to the need to train those residents. Since small businesses often cannot afford to train workers, providing for the Federal Government to offer training was mentioned as an important incentive to assist small business development.

Some proponents of enterprise zones had suggested that providing businesses with a reduced minimum wage could be one way of reducing an employer's labor costs and thereby attract businesses. Generally, small businesses witnesses agreed that providing a wage subsidy to employers would be valuable. However, many of them felt a reduced minimum wage would only detract from the concept while other forms of subsidy could be used. As G. Cheston Carey, President, Carey Machining and Supply Company, Inc., a distributor of industrial supplies in Baltimore, stated:

> I honestly hate to see the legislation get bogged down in the bitter controversy over a lowered minimum wage, but I do believe there is major assistance that should be given in the early years such as refunds of some significant value for the hiring and keeping of CETA-eligible employees. This refund (as opposed to tax credit carry-forwards, which could be conceived of as useless) should be limited to the first year, after which it should become a tax credit.

While a tax credit to employers as a wage subsidy was considered beneficial, small business owners also pointed out that Federal job training programs which had benefited small businesses ought to be considered for enterprise zones. Several stressed that provisions of the Comprehensive Employment and Training Act of 1978 (CETA) had been useful to meet business job training needs and ought to be considered in the context of enterprise zones.

Charles Bridges, President of DYNA-KOR Micrographics, Inc., a microfilm service bureau, and Gene Harris, President, Electro-Mechanical Assembly Company (EMAC) an electronic component painter, of Oakland and east Oakland, California, both located in high areas of unemployment, both used funds under title VII of CETA, Private Industry Councils, to train workers. For Bridges, acquiring skilled production personnel in the high technology area of neurographics was difficult because that usually requires hiring personnel from other firms. As a start-up business, the cost of hiring those people was prohibitive. As he stated:

> To solve that problem, DYNA-KOR initiated a training program to develop skilled microfilm technicians. Funding for this program was provided by the Oakland Private Industry Council under title VII, and 5 of the 10 original training participants became the production staff for DYNA-KOR. The other five participants were placed in other companies.

Harris also used title VII recipients as well as tax credits. As Edwin T. Crego Jr., President of Consult Ltd. of Chicago, suggested, a creative use of existing Federal training programs, particularly title VII of CETA, "would work to give the employer the advantage of paying below minimum wage out of its own pocket without harming the employee's wage stream."

Also of particular concern beyond the new skill level of the zone population was their general "employability" or attitude toward work. As Carey noted:

> I think that small business needs outside support in significant quantities to make the equation appear favorable. A lot of us have heard the story about Control Data, where they put a plant in I believe it was downtown Minneapolis, and they found that particularly on Mondays they had a very reduced work force. They found out that a lot of them were in jail, so they send the corporate counsel down there to get them out and they turn their human resource division loose on them and give them counseling.
>
> Small business cannot afford these kinds of luxuries so we have to provide these kinds of help for them in the enaterprise zones. These include such things as counseling on how to hold a job, how to apply for and hold a job; all the problems of drug and alcohol abuse; some of the business services like lawyers and accountants and the like.

*Need for community support*

An underlying theme of the enterprise zone proposals has been to emphasize the role of local communities in the process of revitalizing distressed communities. The importance of having local community support and involvement was mentioned by several witnesses as an essential ingredient which ought to be addressed. For example, the lack of tax incentives in any legislative proposal to address this point was viewed by business persons and commentators as a fatal flaw. In the listings of the concerns which influenced businesses decisions not to locate in the inner city, the fear of crime or the lack of a civil environment was always near the top. As Stuart Butler stated:

> If an enterprise zone is to be a mechanism to reduce these barriers it must therefore accomplish two things. It must set in motion a process of change that allows and encourages an improvement in the social conditions in the area, with a view to reducing the incidence of crime, im-

> proving cooperation between businesses and residents for mutual benefit, and generally reducing the risks associated with business formation.
>
> To improve social environment for inner city businesses, we should build on the remarkable successes of neighborhood organization. In cities across the nation, they have managed to cut crime by mobilizing residents, to provide day-care centers which enable mothers to work, to screen and to discipline young workers for entry-level positions, and to deliver security services for local business.

Witnesses agreed that community based organizations were one of the sources of outside support that small businesses would need.

*Conclusion*

It was clear from the testimony by witnesses that they were confident that the concept of enterprise zones could work if the proper incentives were provided. While reservations were expressed with respect to focusing strictly on tax incentives, the "right" kinds of tax incentives were considered important. Tax incentives, as well as other kinds of Federal assistance, would have to be targeted to the special needs of the enterprise zone firms. While most legislative proposals, in the judgment of most of the witnesses, seemed to have failed to recognize the special needs of small businesses, witnesses did suggest creative ways in which small businesses needs could be addressed by tax incentives. Moreover, witnesses stressed that the framework would have to be flexible and allow businesses to operate profitably. As David Dullum, President of Frontenac Capital Corporation of Chicago, Illinois stated:

> I believe the enterprise zone proposal has merit. However, I wish to emphsize that it needs to be pragmatic and a true incentive for investment which can by quantified in terms of a rate of return on investment. In this regard, the main tenet has to be that if a company is going to either do business in or be attracted to an enterprise zone, then the fundamental business concept must be sound and not just provide an opportunity for someone to take advantage of tax concessions.

Important to determining the soundness of the business proposition, said Dullum, will be the entrepreneur's perception of the opportunities "to enhance the rate return on the investment."

The Small Business Committee will continue to work with the committees of direct jurisdiction over concepts of enterprise zones legislation in the 98th Congress.

### B. THE IMPACT OF CRIME ON SMALL BUSINESS

In 1982, the Committee on Small Business, at the request of Senator D'Amato, Chairman of the Subcommittee on Urban and Rural Economic Development, held a series of hearings on the impact of crime on small businesses. The Committee held field hearings in New York City on August 16, 1982; in Albany, New York on October 18, 1982; and in San Francisco on November 15, 1982, Senator D'Amato chaired all of these hearings. The purpose of these hearings was to explore, in depth, crime and its effects on small businesses of America.

*There is little doubt that* crime *has* become one of the biggest threats to small business. In 1980, there were over 533,000 robberies nationally, as reported in the uniform crime reports compiled by the U.S. Department of Justice. Of these robbery victims, more than 130,000 were business owners whose estimated total loss exceeded $100 million. On top of these robberies, over 1,197,000 "nonresident" burglaries were also reported in 1980, costing another $858 million in estimated losses. That adds up to a total of nearly $1 billion lost by business to robbers and burglars.

From law enforcement and government officials, the Committee heard testimony concerning the causes of crime, which included the following:

Repeat offenders;

Lack of sufficient law enforcement personnel;

Early parole;

Poor cooperation between Federal, state and local law enforcement agencies;

The growing illicit narcotics industry;

Court decisions favoring the criminal; and

Overcrowded prisons.

As part of its investigations, the Committee believed it to be absolutely essential to hear from crime victims in order to fully understand the effects of crime.

At the August 16, 1982 hearing in New York City, for example, the Committee heard from Alfred Rivera, owner of five liquor stores in New York City. He testified that he was forced to sell all but one of the stores, "mainly for safety * * * I could not tolerate all the thefts, all the break-ins." Rivera's father was killed in a grocery store robbery, his brother was shot, and he has been involved in several shootouts with would-be robbers. As soon as he could afford it, he moved his family to a safer neighborhood in New Jersey.

Another witness, Josephine Scalisi, who previously had been very active in community affairs, has been living a reclusive life since she was forced to sell her jewelry store in Staten Island. Her husband was killed in her presence during a robbery. She felt that she could no longer carry on the business after his brutal murder and said that this sort of violence and traumatic experience forced her out of business. As she stated, "when that happens to your partner in business, your husband, it doesn't make any sense to go on."

James Schiffer, the owner of a pharmacy in Brooklyn, New York testified that he had been the victim of at least fifteen robberies in different stores. It happened so often that he said he became "accustomed" to being victimized. In one case, he attempted to escape out the back door but the robber caught and shot him and then forced him back into the store where he was again beaten. Schiffer is now unable to get crime insurance for property protection because of the pervasiveness of the crime problem in his community. He has been forced to wear a bullet proof vest at work and customers have to be buzzed through the front door via a security system.

Witnesses at the Committee's Albany, New York hearing recounted similar atrocities. Amelio Ditale, the owner of a tailor shop, was beaten senseless with a brick by two assailants who robbed his store. He survived, he testified, because he managed to fight them off with a pair of scissors. Of the six victims who testified in the Albany hearing, all six were assailed by convicts on parole or someone out on bail awaiting trial for another crime. Another victim, Gary Geiger of Schenectady, New York, still carries in his abdomen the bullet of a robber who shot him in the back during the holdup of a local hotel that he had been working in. He said because of this incident he would never work nights again.

During the Committee's crime hearings in San Francisco, the Committee again heard from victims who were asked to recount their tragic experiences to the Committee.

Eugene Schmidt, the owner of a jewelry store, told of being the victim of robberies three times within the last four months. In one robbery his wife was killed; in another, over $120,000 in jewelry was stolen; and in the last robbery he was saved only because an off duty police officer was in the store and was able to assist him in the "shoot out".

Lynn MacMeekin, a bar owner, told him of being shot three times at point blank range when his bar was robbed. He was close to death for two weeks. While in the hospital, he had to receive 39 units of blood during the operation alone and lost 50 pounds. He received a hospital bill of $33,000, and begins to break out in a cold sweat each day at 5:30 p.m.—the time when the robbery occurred. He fears that he will never fully recover and will "never get back to normal" again.

Ellen Twitchell, a restaurant manager, was held up at gunpoint. She said one of the robbers hit her with his fist "square in the mouth," kicked her in the ribs when she was forced onto the floor and stole her car from the parking area. She hasn't seen the car since.

Another witness, Clifford Catsoulis, a bakery worker, testified that the bakery in which he works has been robbed about once a month for approximately the past three years. In the most recent robbery, he and other employees were held up by men carrying a sawed-off shotgun.

Bonnie Maler and Thomas Malcamp, owners of a small camping goods store for the past five years, testified that they had been robbed and assaulted five times, either at knifepoint or gunpoint. In one case, Mr. Malcamp was stabbed and received a deep puncture wound that just missed his lungs. Ms. Maler concluded, "* * * I am really terrified being in my own businss alone * * * it is just a matter of time before it happens again."

It was clear from the Committee's hearings that there is a growing perception in America that the fabric of our society is being torn apart by a crime wave that knows no bounds. The Congress has responded with passage of the Omnibus Victims Protection Act of 1982, to encourage greater consideration of the rights of victims of crime in Federal cases. The Congress also passed the Violent Crime and Drug Enforcement Improvements Act of 1982, which, among other things, would allow those charged with a Federal crime to be held for trial without bail when it is determined that their release would endanger society. In this way, criminals with a history of violent offenses could be kept off the streets.

Such "preventive detention" measures have been suggested by two new studies prepared for the Department of Justice by the well-respected Rand Corporation as a means of dealing with the "omni felons" who comprise the career criminal element responsible for the majority of all violent crimes.

The Administration's recent announcement that it would step up its battle against organized crime and drug trafficking was also announced. The President recognized that additional resources will be needed to successfully combat crime, including new prisons to hold the additional criminals this nationwide dragnet will snare.

Said Senator D'Amato at the close of the final hearings:

> While the primary duty for the administration of criminal justice rests with State and local governments, all levels of government have a duty to deal with the crime menace. Crime is not somebody else's problem. It's everybody's problem. It should be attacked from the local courthouse to the State house to the Houses of Congress.
>
> We must undertake this concerted national effort because "domestic tranquility" means more than freedom from foreign invasion or domestic insurrection. It means safety in our communities and security for our businesses. In a word, it means peace for a society where the rule of law has been subverted by violent thugs and where freedom from fear is slipping further away from all of us.

The Committee will continue to look into the problem of crime and its impact on small business in the 98th Congress.

### C. INDUSTRIAL DEVELOPMENT BONDS

On August 24, 1981, the Internal Revenue Service issued Revenue Ruling 81-216 which set forth guidelines for determining whether aggregatd offerings of "small-issue" tax exempt bonds would be treated as a single issue or a multiple lot issue. The ruling reversed previous IRS interpretations and held that multiple lots of bonds of $1 million or less would no longer be tax-exempt. The ruling eliminated an important source of capital for small businesses by closing down programs run by state agencies which issued "umbrella" bond packages specifically designed to assist small businesses and small farmers in obtaining reasonably priced financing.

Chairman Weicker immediately initiated an effort to suspend the implementation of that ruling. On September 11, the Chairman, along with 12 other Senators, wrote to Treasury Secretary Donald Regan, urging that the ruling be postponed. Pointing out the reversal from IRS previous policies and rulings—upon which states had relied in developing their programs—the coalition of Senators wrote:

> We believe this is a most inauspicious time for taking this precipitate action. Interest rates are at an all-time high for small business; conventional small business and agricultural development assistance is being sharply cur-

> tailed; and greater reliance is being placed on state governments for local economic development. Farmers and small businesses, the frontline troops in the anti-inflation battle, are already being devastated by high interest rates. This ruling would make matters much worse.

Taking notice of Congressional interest in the small-issue bond program, which had been sparked by a Congressional Budget Office report on the rapid growth in the use of small-issue bonds, the letter continued:

> Furthermore, this ruling preempts possible Congressional action this year to modify the use of industrial development bonds. The House Ways and Means Committee expects to continue its consideration of this entire issue during this Congress. Accordingly, promulgation of this ruling prejudges Congressional determination and may very well foreclose Congress' opportunity to take contrary action.

In that connection, on September 17, 1981, Senators Weicker, Durenberger, Stevens, Andrews, Cohen, D'Amato, Dixon, Dodd, Pressler, Pryor, Tsongas, and Warner also introduced S. 1635, directing the Secretary to delay the application of 81–216 until January 3, 1983.

Later in September, the Administration sent to Congress a number of proposals to raise revenues. Listed among those plans to close business tax loopholes over 3 years, was a suggestion to eliminate tax-exempt industrial development bonds.

On October 5, 1981, Senator Alfonse D'Amato, Chairman of the Subcommittee on Urban and Rural Economic Development of the Small business Committee, conducted a hearing on Industrial Development Bonds. That hearing produced testimony strongly supporting a continuation of the pooling of IDB's and rejection of the IRS position. Most of the witnesses were from states which had run successful programs using tax-exempt bonds. As John Carson, then Deputy Commissioner of the Department of Economic Development, State of Connecticut stated:

> What troubles us most, I think, in the State of Connecticut, which has had a long history of using tax-exempt financing, and particularly the revenue umbrella bond program, is that the IRS has, by executive fiat, eliminated what we believe is the best of all revenue bond programs and truly one program that aids small viable businesses.
>
> In effect, by that ruling, the abuses which have been heard and discussed by the Congress over the past few months, in terms of tax-exempt financing, have been left untouched, while small and medium-sized companies who need this economic encouragement the most are being penalized.

Similar sentiments were expressed by other witnesses.

Following the hearing, Senator D'Amato wrote to Secretary Regan, telling him of the concerns voiced at the hearing and inviting the Secretary to appear before the Committee to present the Administration's views.

On October 8, 1981, the IRS proposed regulations that adopted essentially the same position as the revenue ruling. In those regulations, the IRS provided for processing or "grandfathering" issues which involved significant financial commitment prior to the effective date of August 23, 1981.

During Senate Appropriations Committee consideration of H.J. Res. 357, making continuing appropriations for fiscal year 1982, Senator D'Amato offered an amendment which prohibited the Treasury Department from using any funds appropriated under the Act to enforce the revenue ruling. When debated on the floor, a substitute amendment co-sponsored by Senators D'Amato, Dole, Weicker, Stevens, Dixon, and others was agreed to. Although House Joint Res. 351 was later vetoed by the President, a similar amendment, again co-sponsored by D'Amato, Dole, Stevens, and Weicker, was adopted, passed and signed into law. The latter amendment prohibited the IRS from enforcing revenue ruling 81-216 until March 31, 1982 (Section 112 of Public Law 97-92).

Enactment of that amendment, however, did not revive the umbrella bond programs. To the contrary, the Treasury Department interpreted the amendment as prohibiting them from taking any action with respect to the revenue ruling. In administering the amendment, the IRS ceased processing issues which were in the pipeline prior to the date of the ruling. Furthermore, on February 26, 1982, the Administration sent to Congress the President's proposed tax changes for raising revenue. Among the proposals was a significant modification of the use of tax-exempt industrial development bonds.

During Senate Finance Committee hearings on the Administration's proposals on March 17, 1982, Senators Weicker, D'Amato, Stevens and Tsongas testified in opposition to the Administration's proposals for reform of the IDB program. As with the earlier IRS actions, they argued that the Administration's proposals on IDBs were ill-timed, counterproductive and unnecessary. Instead of adopting the Administration's proposals, the Senators argued that the Finance Committee should reject the proposals and reverse the revenue ruling. On April 1, 1982, Weicker, D'Amato, and Stevens, along with fifteen other Senators, introduced S. 2335, to reverse Revenue Ruling 81-216 and to permit states to proceed with their umbrella bond programs. Chairman Weicker stated in his introductory remarks:

> Now is the time when we should be seeking out ways to get low-cost financing to our small- and medium-sized businesses for expansion and development, not slamming the door on them. For years, the small issue IDB program has helped thousands of businesses expand and grow, creating new jobs and giving a boost to local economies. For our businesses, for our communities, and for the overall health of our national economy, we must get the IDB program back on track.

In July, during final Senate consideration of H.R. 4961, the Tax Equity and Fiscal Responsibility Act, Senator D'Amato was successful in negotiating a compromise agreement with Finance Committee Chairman Dole, which was eventually included as part of that Act. Under the agreement, the sunset data for small-issue, tax-exempt bonds was extended until December 31, 1986 to December 31, 1983. In addition, it preserved modified ACRS treatment for IDB-financed facilities.

## CHAPTER NINE: MINORITY BUSINESS DEVELOPMENT

It has become increasingly apparent in recent years that small and minority-owned small businesses are the key to this nation's economic recovery and continued prosperity.

With business failures at record high levels and unemployment increasing at an alarming rate, particularly in the minority business community, it is clear that the Congress and the Administration must begin to search for solutions. In that search, the Committee believes that the essential contributions of minority businesses to our economy and our communities not be overlooked. Nor should the Congress and the Administration overlook the important role our minority business can play in putting the economy back on its feet again.

If plans for local economic development, job creation, and the renewal of our urban areas are to succeed in the months ahead, small and minority small businesses will have to be part of that solution. Unfortunately, the full potential of the minority business community has yet to be realized.

The Committee on Small Business has long been committed to programs which foster minority business development. Clearly it makes good sense, both in economic and in human terms, to promote minority business through effective Federal and private sector programs.

To this end, the Committee has consistently encouraged and provided funding for such SBA programs as the 8(a) procurement program, which sets aside government contracts for qualifying firms, and the Minority Enterprise Small Business Investment Company program, which provides long-term, low-interest loans to promising minority entrepreneurs.

But what has been done in the past is not sufficient for the future. We need to continue the process of bringing more minority participants into the country's economic mainstream, and Committee members believe we ought to acknowledge and reaffirm the Federal government's role in, and commitment to, this goal.

### A. ROLE OF MINORITY BUSINESS IN THE ECONOMY

On June 23, 1982, the Small Business Committee held a hearing at the request of Ranking Minority Member Nunn, to review the major contributions of minority businesses to the nation's economy, and to better assess their current and future economic needs. The Committee heard from a number of successful minority entrepreneurs and government witnesses who attested to the success and growth of minority business in the past few years, and who spoke about the needs for the future.

Senator Nunn's opening statement put the purpose of the hearing in context:

> Most of the attention that has been focused on the Federal efforts to assist in the growth and development of minority businesses have tended to focus on the negatives in those programs, including the potential for "waste, fraud, and abuse" or the differences in opinion on the appropriate day-to-day program implementation.
>
> For that reason, I suggested to Senator Weicker that our committee hold a hearing to show the positive contributions that minority businesses provide to the economy and to society, and to highlight both their role in the nation's economic recovery, and their special relationships with the Federal government.
>
> As unusual as it may seem, this simple recognition of the contributions that minority businesses make to our society is a very important step at the National level. If we are to allow minority businesses to develop to their maximum, policy-makers at all levels must be aware of the significant role that they play, and what barriers still exist to their further development.
>
> But I want to be sure we understand that, while we can assemble an impressive witness list of success stories in the minority business community, there are not yet enough successes to be confident that we have addressed the problems which the minority entrepreneur faces.

Earl Graves, the creator and publisher of Black Enterprise magazine, noted that his publication had recently examined the growth of leading black-owned companies in America in the last decade. Mr. Graves pointed out that total revenues for the top 100 black-owned businesses grew by 24.2 percent in 1981–1982, from $1.5 billion to $1.9 billion. When his magazine first began to compile this top 100 list of companies 10 years ago, sales for this group totaled only $459 million. After adjusting for inflation, Graves said, this represents a real growth increase of more than 80 percent.

At the same time, however, John Hall of Mark Battle Associates of Washington, pointed out that while the largest firm in the Black Enterprise 100 did indeed have phenomenal growth in 1980, resulting in revenues of $92 million, the top Fortune 500 firm recorded revenues of $76 billion for a comparable time period. He indicated that the statistics were "reflective of the underutilized capacity of the minority business community."

Nonetheless, Committee members agreed that the growth of minority firms in the face of a decade of unrelenting inflation, an ever-present energy crisis, inordinately high interest rates, severe credit crunches, and the traditional problems minority firms have in gaining access to capital, demonstrates the increasing important potential of this sector of the economy. The testimony also pointed out that top minority-owned companies are no longer dominated simply by service and consumer-oriented businesses, but have diversified into other areas, including high-technology businesses and energy distribution.

Government and private sector witnesses at the hearing agreed that the Federal government's support of the minority business community cannot falter if more minority entrepreneurs are to develop and participate on an equal footing with non-minority firms in this economy. Witnesses argued that the Federal government must continue and expand its efforts to provide an economic environment in which qualified minority businesses have access to investment capital, markets, management, financial assistance and federal procurement. In the view of those testifying before the Committee, this means that the programs of the past must now be developed for both existing and future government programs.

## B. 8(a) PROGRAM

### *Background*

Section 8(a) of the Small Business Act authorizes the SBA to enter into contracts with other Federal agencies and to then subcontract the work to small economically and socially disadvantaged persons. Prior to 1978, the 8(a) program, as administered by the SBA, was used to locate appropriate contracts which minority firms could then apply for. The program lacked any specified mission beyond this contract assistance and thus failed to promote any appreciable business growth. Without achieving some business development, minority firms were unable to successfully operate in the private sector without continued government contracts. The Committee its oversight of the SBA's minority business development program, particularly the Section 8(a) program.

### *The 8(a) pilot procurement program*

In 1978, Congress enacted Public Law 95-507 which reconstructed the 8(a) program and placed a greater emphasis upon business development. The SBA was required to provide contract assistance as well as managerial, technical, and financial aid to qualified firms. In addition, Public Law 95-507 established a separate 8(a) pilot program to provide increased opportunities for minority firms to enter into multiyear, high-technology contracts with a federal agency. The significant language of Public Law 95-507, Section 202(a), which establishes this program states:

> It shall be the duty of the Administration (SBA) and it is hereby impowered whenever it determines that such action is necessary or appropriate * * * to enter into contracts with such agency, as shall be designated by the President * * * to furnish articles, equipment, supplies or to perform construction work for such agency * * *.

Section 202(a) stipulated that no contract could be entered into under the authority of this Act after September 30, 1980.

Under the regular 8(a) procurement program the Administrator of the SBA is authorized to request that certain contracts be included in the 8(a) program. However, the head of the participating agency retains final authority over the decision to award the contract to qualified minority firms. Under the pilot program, the SBA is given exclusive authority to select and to negotiate any contract which SBA deems appropriate for inclusion in the 8(a) program.

The concept of the pilot authority evolved out of a recognition that most of the Federal contracts awarded under the 8(a) program have traditionally been for work in general construction or general services, such as food services or janitorial services. In a 1978 report to the Senate Small Business Committee, the General Accounting Office noted that SBA's ability to develop firms in the 8(a) program was limited by the types of contracts offered by Federal agencies. Hence, Congress in 1978 authorized the pilot program to give SBA the authority to select contracts in nontraditional, high technology areas to develop minority firms in areas with a high potential for economic growth.

On January 10, 1979, President Carter selected the Department of the Army as the 8(a) pilot procurement agency. SBA and the Department of the Army, however, were unable to enter into an interagency agreement setting forth the formal terms and arrangements for their joint implementation of the pilot program until May 24, 1979. The first contract was not signed under the program until September 27, 1979, nearly 1 year after enactment of the pilot authority. Because of the delays in implementation of the pilot program and the Congress' concern that the program had not been fully tested, the program was extended by Public Law 96-481 until September 30, 1981.

On January 23, 1981, at a Committee oversight hearing, the GAO issued their report on the implementation of the pilot program. The report was critical of SBA's implementation of the pilot authority. Based on a review of the first three contracts awarded, GAO thought SBA had made a poor choice of firms and had not used their field personnel in matching firms with contracts.

Besides being critical of SBA's implementation of the authority, the GAO also noted the differing views held by SBA and Army as to the purpose of the pilot program. SBA believed that the authority was designed to improve the quality of contracts going to 8(a) firms; Army viewed the pilot as a means of improving the amount of 8(a) contracts going to 8(a) firms. The GAO tended to agree with both views. They found SBA's objective laudable, and they agreed with Army's position that an agency which had not supported the program ought to have been selected as the pilot agency. GAO therefore recommended to the Congress that the authorizing legislation be amended to allow for further testing of the pilot program in another agency.

On August 6, 1981, Senator Weicker wrote then-Administrator Michael Cardenas requesting the SBA's position on extending the program. No official response was received from the SBA. However, program staff indicated that extention of the authority was desirable.

On September 15, 1981, Chairman Weicker introduced S. 1620, legislation to extend the pilot authority for an additional 18 months, until March 31, 1983. In his introductory floor statement Senator Weicker stated:

> The concept of the pilot program is still valid; the need for the authority is as pressing today as it was in 1978 * * *.
>
> While it must be recognized that SBA's exercise of this authority has left much to be desired, we should not let SBA's past shortcomings be the basis for allowing this program with great potential benefits to minority businesses

> to die. With a new Administration to set a new direction this program can have a new beginning.

S. 1620 was referred to the Senate Committee on Small Business which held legislative hearings on the bill on September 21, 1981.

Witnesses at the hearing included the SBA, GAO, associations who represented minority contractors and a contractor representing a construction association. With the exception of the construction contractor, who was particularly concerned about the large number of construction projects reserved using pilot authority, most of the witnesses called for an extension of the authority.

Although the GAO report to Congress on the pilot program recommended that the program be extended, it also raised serious questions about SBA's management program. GAO found that SBA had not adwquately assessed the capabilities of the firms chosen to perform the contracts under the pilot program and had made little use of its field offices and personnel in selecting or analyzing requirements for the program. The GAO report made specific recommendations to the Administrator of SBA on changes needed in the mangement of the program before SBA reserved further procurement requirements or awarded additional contracts to 8(a) firms.

At the September 21, 1981, hearing on S. 1620, SBA Administrator Michael Cadnas said that, "SBA concurs with the analysis and recommendations of the General Accounting Office concerning the past management of the pilot program."

Mr. Cardenas assured the Committee, however, that SBA could and would successfully manage the 8(a) pilot authority if it were extended. Mr. Cardenas presented the Committee with a plan of action for exercising the authority if it were to be extended which included: establishing a formal procedure of the mutual evaluation by SBA and the designated agency of the capability of firms selected for the pilot; exploring with the designated agency a procedure for selecting the most capable firms to perform a particular project; and maintaining tight mangement controls to monitor the execution of pilot projects. Mr. Cardenas further stated:

> In light of the new management direction being applied to the 8(a) program, I believe SBA can successfully manage and execute the continuation of the pilot experiment with a civilian agency.

In offering the full support of SBA and the Administration for the legislation to extend the pilot program, Mr. Cardenas emphasized that:

> The new Administration would like to have the opportunity to administer this experiment on an effective and competent manner * * * Under my management, SBA's approach will be one of cooperation and prudent business judgment.

On September 22, 1981, with a quorum present, the Committee by unanimous vote, ordered S. 1620 favorably reported. The legislation extended the authority for 18 months and required the President to designate a non-defense agency to participate in the pilot program. No final Congressional action was taken on this legislation, however.

### C. 8(a) GRADUATION AND SIZE STANDARDS

In the 96th Congress, the Committee noted in its review of SBA's administration of the Section 8(a) program that the agency had not aggressively established and reviewed the business plans required to be submitted by all program participants. Also the Committee noted that SBA had failed to act in a timely fashion to review the graduation potential of firms in the existing portfolio. To address these problems the Congress passed Public Law 96–481 (enacted October 24, 1980). During the 97th Congress, the Committee monitored the SBA's implementation of that law.

P.L. 96–481 requires that SBA negotiate a fixed program completion date for every firm in the program. Each firm is required to submit business plans to SBA upon which the completion date will be established. Also, the law set out a very specific timetable for SBA to implement the provisions: within 120 days of enactment of the law SBA was required to establish final regulations; two months after issuance of final regulations, firms in the program were required to submit to SBA business plans; within 18 months after the effective date of the law SBA was required to establish dates for all forms in the program; and SBA was prohibited from awarding or extending contracts for firms which had not established a program completion date before June 1, 1981.

After enactment of P.L. 96–481, SBA did not move expeditiously to implement the law. The delay was in large part due to the Presidential election of November 1980, and the subsequent change in the Administration. On January 16, Acting Administrator William Mauk wrote to Chairman Weicker to advise that SBA would have difficulty meeting the June 1, 1981 statutory deadline. Mr. Mauk's letter pointed out that while the framework for regulations had been established, "it (was) highly improbable that negotiations with 2000 firms could be complete (by June 1)."

On March 26, 1981 Michael Cardenas was confirmed by the Senaate as the new Administrator of SBA. On May 1, Mr. Cardenas held a press conference and announced as his first major initiative his "new tough" policies for the 8(a) program. Mr. Cardenas' new initiatives was a direction to all regional offices to produce size standards determinations on about 40 firms in the 8(a) program. According to Cardenas, "those found to be large businesses will be terminated from the 8(a) program. Additionally, SBA will review the 2,130 firms now in the SBA's portfolio for program completion, termination or improved opportunity." Mr. Cardenas also mentioned that the agency would soon move to set program completion dates for new and current participants in the program, i.e., enforcing the provisions of P.L. 96–481.

On May 13, Administrator Cardenas wrote to Chairman Weicker that SBA had completed a detailed review of the 8(a) program. Mr. Cardenas set out his future plans for the program as follows:

> To redirect the program to serve all of the clients that it was originaly intended to serve. Each year clients must complete the program and new entries must be given their opportunity to participate. There are literally thousands of companies that have been precluded from program participation while at the same time a few favored program par-

ticipants have received hundreds of millions of dollars on noncompetitive support. The equity of the situation demands change and there is no doubt of the future of greater program participation by the small, socially and economically disadvantaged businesses in the country.

With the impending June 1 statutory deadline, concern began to surface that the 8(a) program would be shutdown since regulations had not yet been adopted and no firms had dates set.

On June 1, 1981, SBA issued a notice of proposed rulemaking to establish fixed program participation terms (FPPT's). To allow firms to continue to receive contracts while the regulations were pending, SBA at the same time also issued an interim emergency regulation which temporarily gave all firms in the 8(a) program a temporary completion date of 6 months, or until November 30, 1981 when the final regulation became effective and SBA would begin setting FPPT's.

The final rule was published on November 23, 1981 and shortly thereafter SBA began to negotiate program completion dates. By April 22, 1982, SBA had established dates with all firms in the program, in compliance with the law. Under the regulations, no firm received a term of less than one year. This was done in order to allow for firms to plan for orderly exit for the program.

*Size standard*

On June 16, 1982, the General Accounting Office rendered an opinion on a protest of the award of a contract to an 8(a) concern. That opinion held that the SBA must suspend contracting with any 8(a) firm found to be other than a small business as a result of an SBA size determination. (Matter of Computer Data Systems, Inc., File: B-205521.) Pursuant to the GAO decision, SBA Administrator Sanders on June 17, 1982 issued a directive to all field personnel informing them of the decision and stating that no new contracts should be awarded to those firms which had been found to be other than small.

As a result of the earlier size review ordered by Administrator Cardenas, during the previous year, 23 firms had been found to be other than small. Under program regulations, however, those firms could not be terminated from the program without a hearing. In practice, however, enforcement of the GAO decision preventing awards of new contracts had the effect of graduating those concerns.

Shortly after the June 16 opinion, Administrator Sanders requested that the Comptroller General reconsider his opinion. While the reconsideration request was pending, a lawsuit was filed in the D.C. Federal District Court, and a temporary restraining order was issued by the Court to keep the Administrator from enforcing the GAO opinion.

On July 26, the GAO rejected the Administration's arguments and upheld its earlier decision. Shortly therafter on July 30, the District Court ruled that the GAO opinion and reconsideration were correct. Although the court said that "we conclude that contract assistance cannot continue after an 8(a) firm has formally been found other than small" the court had noted earlier in its opinion that Congress had left the determination of size standards to SBA. The court said: "Congress could have legislated such an exception, and SBA could have administratively created different size standards for 8(a) as opposed to non 8(a) concerns. Neither had done so."

While the GAO and court proceedings were pending, Administrator Sanders, as well as Committee staff met several times with representatives of the affected firms. Those discussions pointed out that over the course of the last year most of the affected firms had negotiated their fixed program participation terms with the expectation that they would be eligible for contracts until that date. Their business plans had been developed relying on support to that date. Coming in the fourth quarter of the fiscal year, generally accepted as the heaviest contracting period of the procurement cycle, they pointed out that contracts which they had been soliciting over the whole year would now be lost. For many of them this would result in substantial losses and perhaps bankrupt. They urged the Administrator to exercise his discretion to avert the potentially devastating consequences of the GAO opinions and court decision.

On August 12, an SBA emergency interim rule was published, effective upon publication for 180 days, which raised the size standard for those firms in order to permit them to continue to receive contracts. Regarding the Administrator's decision, announced on August 10, 1982, Chairman Weicker said:

> I strongly support the decision made by SBA Administrator Jim Sanders today. I would point out that this decision is the result of intense negotiations, which I personally have been involved in since their inception. I believe the solution being offered is equitable, fair, and most importantly, reflects my particular concern that no undue hardship be inflicted on any firm in the resolution of this problem.
>
> First, the compromise being offered today ensures that these companies will have adequate time to prepare for graduation, and that they will be able to make a smooth, orderly transition out of the program without placing an undue burden on themselves or their employees.
>
> Secondly, it recognizes the congressional intent in developing this program that it should assist as many small, minority firms as possible, bringing each of them to the point where they can be self-sufficient and successful. In these difficult economic times, many small minority firms are desperately searching for working capital and federal contract support. The action taken by the Administrator today will help to ensure that more of these firms will be afforded the same opportunities for assistance and advancement that other 8(a) cretified firms have had.
>
> Taken together, I believe these actions can only result in a stronger, healtheir 8(a) program, and ultimately, in a stronger and healthier minority business community.
>
> I want to commend the Administrator for the sensitivity and skill he has shown in handling this difficult issue. Faced with a court ruling and an opinion by the GAO, he

worked diligently to find a solution that would uphold his agency's commitment to the minority business community, while at the same time adhering to the mandate given him by the courts and the GAO. On this issue, Jim Sanders has shown that he is willing to go the extra mile for his small business constituency; the result is a decision that is thoughtful, compassionate and fair.

## CHAPTER TEN: BROADENING THE VOICE OF SMALL BUSINESS

A cornerstone of this country's free enterprise system is every man and woman's right to the "entrepreneurial dream": a dream that any person in the U.S. can someday own and operate an independent business with an equal opportunity for success. Every year, thousands of people apply for the requisite permits, licenses and certificates necessary to start their own business. Even in periods of recession, hundreds of firms offering every conceivable good or service open their doors. And each one of them begins in the same way—as a small business.

Today, small businesses represent approximately 90 percent of U.S. industry. Statistics show that these small firms account for about half of the gross national product; provide over 75 percent of the new jobs created in the U.S., and are this country's most efficient and fertile source of innovation. Yet, despite these amazing contributions, the small business sector has traditionally not been given its due by Federal policy makers.

Historically, small business has suffered from a lack of political clout for two reasons: first, small business owners historically have not been organized. Owning and operating a small enterprise is a full time job, one that leaves little time for association meetings or legislative conferences.

Secondly, the small business sector is as diverse as the American population itself. There is often little room for consensus on so-called "small business" issues. As a result, total agreement on specific policy recommendations is rare.

In 1980, the White House Conference on Small Business attempted, for the first time, to bring entrepreneurs together and establish a national small business agenda on small business problems. Thousands of delegates met around the country and in Washington to discuss and identify the most common small business problems and to recommend possible solutions.

The White House Conference was a milestone for small business in this country. First, many of the key Conference recommendations have been enacted on by the Congress, solving many small business problems. But even more importantly, the Conference set a precedent by giving small business national recognition and by focusing national attention on its problems. As a result, the small business community was infused with a new sense of political importance, and a willingness to organize and promote small business causes. These sentiments have continued to grow in the months since the White House Conference, evidenced by a number of statewide small business conferences that have been held throughout the country over the last two years.

The Senate Committee on Small Business has worked diligently to keep the small business community involved in policy formulation. Through innovative and creative outreach programs, the Committee has sought small business advice and counsel in a number of areas. In meetings with small business leaders, the establishment of the first Senate Advisory Council, and other small business activities, we believe the Committee has helped to broaden the voice, and increase the clout of the small business community.

### A. SMALL BUSINESS COMMITTEE STATUS

The Senate Small Business Committee was created in 1950 as a select committee to study and survey "by means of research and investigation all problems of American small business enterprises, and to obtain all facts possible in relation thereto which would not only be of public interest, but which would aid the Congress in enacting remedial legislation." At the time the Committee was created, it was not given any legislative authority.

However, unlike most select committees, the Select Small Business Committee was not given a termination date, and in fact, as time went on, it became more and more established as force in the Senate. In 1976, the Senate passed Resolution 104, giving the Committee legislative authority and specific responsibility had previously been under the jurisdiction of the Senate Banking Committee.

In effect, passage of S. Res. 104 gave the Committee all the powers of a full, standing Committee. Further recognition of the growing importance of the Committee came in 1978, when the Committee membership, originally set at nine, nearly doubled to 17 to accommodate requests from Senators wishing to be members. For the 98th Congress, the membership of the Committee will increase again, to 19.

Nonetheless, the "select" designation remained. While this designation was in name only, and did not limit the Committee's legislative authority in any way, Committee members felt it implied an impermanence unbefitting a Committee with such a large and vital constituency.

Upon assuming the Chairmanship, Senator Weicker set as his first priority the elevation of the Small Business Committee to full standing status in the Senate.

On March 25, 1981, the Senate unanimously approved a resolution sponsored by Majority Leader Howard Baker, Minority Leader Robert Byrd, and the entire membership of the Small Business Committee, striking the "select" designation and awarding the Small Business Committee full, permanent status. However, the resolution in no way altered the Committee's existing authority or jurisdiction.

By adopting this Resolution, said Weicker, "the Senate has sent a clear signal to the American people that the problems of small business are not to be ignored or forgotten, but the small business community and its advocate, the Senate Small Business Committee, are here to stay."

## B. THE NATIONAL ADVISORY COUNCIL

On June 22, 1981, the Chairman and the Ranking Minority Member announced the formation of the National Advisory Council to the Senate Small Business Committee. The Advisory Council—the first of its kind in the Senate—was established to provide Committee Members with regular, grassroots input from small businessmen and women in the field. According to Senator Weicker, "These people are in the best position to tell the Committee how problems such as inflation, high interest rates, and excessive Federal regulations are actually affecting their businesses, and if the solutions we are considering in the Congress will actually help them in solving these problem."

Senator Nunn concurred, saying: "The small business community must be in the forefront of our efforts to revitalize the national economy if these efforts are to be successful. Small business nationwide is the backbone of our free enterprise system."

"I believe the Small Business Advisory Council can make a valuable contribution to the work of the Senate Small Business Committee and the entire Congress as we seek solutions to the problems which face small business today," Nunn said.

The Council is made up of 26 small business men and women from around the country, each selected by Members of the Committee. Council members pay all of their own expenses to meet with the Committee twice a year in Washington. Proceedings of these meetings are recorded, published, and distributed to appropriate government agencies and the small business community. In addition, Advisory Council members maintain regular contact with Committee Members throughout the year, so that there is ongoing communication between the Council and the committee on a variety of small business issues.

The Small Business Committee's National Advisory Council held its first meeting on October 28, 1981. At the meeting, the Council elected Connecticut Businessman Shaw Mudge as its Chairman and Mary Diener, a public relations executive from North Carolina, as its communications liaison.

At the close of the first session, the Council unanimously passed a resolution calling on the Committee to take a leadership role in assuring that a small business owner, or someone with considerable small business background, would be appointed to fill the Federal Reserve Board vacancy created when the term of Vice Chairman Frederick Shultz' term expired. In a letter to Senator Weicker, Chairman Mudge wrote:

> After considerable discussion, the Advisory Council came to the conclusion that the special credit and monetary needs of the small business sector of the economy have not been adequately addressed by the Federal Reserve Board. It is our hope that the appointment of a small business man or woman to the Board by the President would do much to increase the Board's sensitivity to the special economic and fiscal conditions that affect a small entrepreneur.

On December 8, 1981, the Senate passed the following Resolution:

### SENATE RESOLUTION 247

Whereas, interest rates have reached record high levels in 1981;

Whereas, high interest rates are having a devastating effect on credit-sensitive sectors of the economy, particularly small business, which includes small farms;

Whereas, business bankruptcies are nearly 50 percent above 1980;

Whereas, Section 10 of the Federal Reserve Act of 1913, as amended, provides that in submitting nominations for the Board of Governors of the Federal Reserve System, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country;

Whereas, the 96th Congress adopted S. Res. 434 stating the sense of the Senate that nominations to the Board of Governors of the Federal Reserve System should reflect consideration of the requirements for regional and economic interest representation;

Whereas, over 97 percent of the businesses in the United States are small business, which account for nearly 50 percent of the Gross National Product, 90 percent of the new jobs created in the private sector, and nearly half of the Nation's industrial innovations;

Whereas, the term of service of one of the members of the Board of Governors is expiring on January 31, 1982: Now, therefore, be it

*Resolved,* That it is the sense of the Senate, that the next vacancy on the Board of Governors of the Federal Reserve System should be filled by an individual who has substantial small business, agricultural or other small business, experience.

On April 22, 1982, the National Advisory Council held its second meeting with the Committee. A variety of important small business issues were discussed during the meeting, including export promotion, economic development, small business innovation and research activities, antitrust policy, Treasury's debt equity regulations, and the U.S. economic climate in general. At the conclusion of this meeting, the National Advisory Council passed a resolution calling for the repeal of Section 385 of the Internal Revenue Code (relating to the definition of debt and equity for Federal income tax purposes) and for the Senate Finance Committee to hold joint hearings with the Small Business Committee on this critical small business issue.

Mr. Bruce Hopewell of New York, expressed these concerns about the proposed IRS regulations:

> One of the principal problems with the proposed regulation is its length and complexity * * * . No one portion of the portion of the proposal can be read without the necessity for reading and analyzing literally dozens of other definitions, exceptions, safe harbors, and so on.

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> Thus the proposed regulation is extremely difficult to understand. Both professional venture capitalists and the operators of young, growing businesses will find it extremely difficult to comply with it.
>
> Moreover, the rules contain a number of arbitrary, objective formulas, the application of which requires precise ascertainment of totally subjective and almost impossible-to-determine faults. Thus, as applied to specific business transactions, the proposed 385 regulation will prevent many transactions from being carried out and will raise substantial tax uncertainties with respect to others.

Mr. James Rhoads of Atlanta, Ga., added these comments:

> From where I sit, the small busines community has an overriding concern that if revenue enhancements are indeed passed, they will be at lease size-neutral with respect to their impact on the business community * * *.
>
> I say this in the context that the Tax Reform Act as passed was perceived by many of us as not being size-neutral, as it might have been, and that perhaps some of the provisions that were passed to help business out, while necessary, might have been a little more weighted in the favor of the larger capital-intensive businesses. I think we would hope that in the event proposed revenue enhancement comes from the business sector, small businesses do not get nailed again, or at least that small firms will be treated on an equal basis.

In response to the resolution, on June 8, 1982, Senators Weicker, Chafee and a coalition of Senators including Committee Members Baucus, Boschwitz, Nunn, Sasser, Rudman, D'Amato, Dixon, Gorton and Huddleston introduced S. 2610, a bill to postpone implementation of IRS regulations. Specifically, the bill would have required any proposed debt-equity revisions to undergo a 180-day Congressional review before the Treasury Department could put them into effect.

In negotiations with the Senate Finance Committee and the Treasury Department during deliberations on the tax bill, Treasury later agreed to postpone its proposed 385 regulations for revision and possible reintroduction only after March 31, 1983. The Committee and the Advisory Council will carefully review any proposed changes that the Treasury Department suggests at that time.

The Committee greatly appreciates the advice and counsel of the National Advisory Council on key small business issues, and looks forward to continuing to work with the members of the Council.

As of December, 1982, the Council members are:

Mr. Hugh Allred, Warehouse Discount Groceries Corp. Cullman, Ala. owner of three grocery stores.

Mrs. Asta Ball, vice president of sales, Miniature Nut & Screw corp., Newington, Conn., sales manager for hardware manufacturing firm.

Mr. James Beavers, Hensley Auto Parts, Clinton, Ark., auto parts dealer.

Mr. Leon P. Brassard, president, Heat, Inc., Hudson, N.H. manufacturer of heating and cooling systems.

Mr. David Bruce, Bruce-Anderson, Inc., Bozeman, Mont., construction firm (general contracting).

Ms. Mary Diener, Diener & Associates, Inc., Research Triangle Park, N.C. business development, marketing research, and marketing services firm.

Mr. William Farden, president, Outdoor Empire Publishing Co., Seattle, Wash., publisher of the periodical "Fishing and Hunting News."

Mr. Walter Floss, Jr., Floss Insurance Agency, East Amherst, N.Y., insurance company.

Mr. Paul H. Hebb, president, Hebb Investment Co. black Butte Ranch, Oreg., investment company.

Mr. Bruce Hopewell, Lincoln Business Help Associates, Inc., New York, N.Y., accountant.

Mr. Oscar Hornsby, Oscar Hornsby, Inc., Somerset, Ky., wholesale petroleum jobber (Chevron USA, products).

Mr. Michael Lefkiades, Michigan Coni Islands, Inc., Bay City, Mich., "fast food" restaurants.

Ms. Helen K. Leslie, president, K & W Supply House, Inc., St. Petersburg, Fla., air-conditioning & heating supplies, sheet metal-insulation.

Mr. Bill Lytle, Waterbury Pen Co., Bridgeport, Conn., manufacturer of ball point pens, markers, desk sets, and other writing instruments.

Mr. Forrest H. Mertz, Mertz, Inc., Ponca City, Okla., manufacturer of exploration equipment for the energy field.

Ms. Thelma Moss, president, AA Glassmobile, Dorchester, Mass., construction firm—installs windows.

Mr. Shaw Mudge, Sr., Shaw Mudge & Co., Stamford, Conn., chairman, national Advisory Council, manufacturer of fragrances.

Mr. Therman McKenzie, M&M Products, Inc., Forest Park, Ga., health and beauty aids primarily for black consumers.

Mr. Bill Nourse, Brookmeade Hardware & Supply, Nashville, Tenn., standard hardware store.

Dr. Arthur S. Obermayer, Moleculon Research Corp., Cambridge, Mass., research firm.

Mr. Francis Ravel, president, Olympic Sales Co., Inc., Los Angeles, Calif., retailer of office computers and office equipment.

Mr. James B. Rhoads, Hyatt & Rhoads, Atlanta, Ga., attorney.

Mr. Ralph H. Steinbarth, president, La Preferida, Inc., Chicago, Ill. 60632, national food and liquor company.

Mr. Glenn Stout, The Maxi-Switch Co., Minneapolis, Minn., designs, manufactures and markets push button switches, keystrip switches and keyboards.

Mr. David Tomlinson, MWEST, Salt Lake City, Utah, distributor of cabinet hardware and related products and systems.

Mr. Morris F. Womack, All Seals, Inc., Friendswood, Tex., manufactures and repairs mechancial seals.

# APPENDIXES

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## APPENDIX A

### Membership of the Committee on Small Business, 97th Congress

LOWELL WEICKER, Jr., of Connecticut, *Chairman*

| | |
|---|---|
| BOB PACKWOOD, of Oregon | SAM NUNN, of Georgia |
| ORRIN G. HATCH, of Utah | WALTER D. HUDDLESTON, of Kentucky |
| S. I. HAYAKAWA, of California | DALE BUMPERS, of Arkansas |
| RUDY BOSCHWITZ, of Minnesota | JAMES R. SASSER, of Tennessee |
| SLADE GORTON, of Washington | MAX BAUCUS, of Montana |
| DON NICKLES, of Oklahoma | CARL LEVIN, of Michigan |
| WARREN RUDMAN, of New Hampshire | PAUL E. TSONGAS, of Massachusetts |
| ALFONSE M. D'AMATO, of New York | ALAN J. DIXON, of Illinois |

# APPENDIX B

## Subcommittees of the Committee on Small Business, 97th Congress

### CAPITAL FORMATION AND RETENTION

Mr. PACKWOOD, *Chairman*

Mr. HATCH
Mr. BOSCHWITZ
Mr. NUNN
Mr. SASSER

### GOVERNMENT REGULATION AND PAPERWORK

Mr. HATCH, *Chairman*

Mr. D'AMATO
Mr. GORTON
Mr. BUMPERS
Mr. HUDDLESTON

### URBAN AND RURAL ECONOMIC DEVELOPMENT

Mr. D'AMATO, *Chairman*

Mr. WEICKER
Mr. DIXON

### GOVERNMENT PROCUREMENT

Mr. NICKLES, *Chairman*

Mr. WEICKER
Mr. SASSER

### PRODUCTIVITY AND COMPETITION

Mr. GORTON, *Chairman*

Mr. NICKLES
Mr. BAUCUS

### INNOVATION AND TECHNOLOGY

Mr. RUDMAN, *Chairman*

Mr. PACKWOOD
Mr. LEVIN

### EXPORT PROMOTION AND MARKET DEVELOPMENT

Mr. BOSCHWITZ, *Chairman*

Mr. HAYAKAWA
Mr. HUDDLESTON

### ADVOCACY AND THE FUTURE OF SMALL BUSINESS

Mr. HAYAKAWA, *Chairman*

Mr. RUDMAN
Mr. TSONGAS

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The Chairman and the Ranking Minority Member of the full Committee are members *ex officio* of all subcommittees.

## APPENDIX C

### Hearings of the Committee on Small Business, 97th Congress

| FULL COMMITTEE OR SUBCOMMITTEE | DATE | SUBJECT |
|---|---|---|
| Full | Jan. 23, 1981 | Open hearing on the Small Business Administration 8(a) Pilot Program. |
| Full | Mar. 9, 1981 | Open hearing on The Role of Small Business in the Nation's Economic Recovery. |
| Full | Mar. 13, 1981 | Open hearing on the Senate Budget Committee Recommendations for SBA programs for fiscal years 1982-1986. |
| Full | Mar. 23, 1981 | Open hearing on the nomination of Michael Cardenas, of California, to be the Administrator of the Small Business Administration. |
| Full | Apr. 27, 1981<br>April 28, 1981 | Open hearing on the Small Business Administration's contracting procedures, followed by a meeting of the Committee in closed session on April 28, 1981. |
| Full | May 5, 1981 | Open hearing on the Small Business Administration's Size Standard Proposals. |
| Full | May 7, 1981 | Open hearing on the Small Business Administration's Pollution Control Financing Guarantee Program and S. 580. |
| Innovation and Technology Subcommittee | May 13, 1981 | Open hearing on S. 881, the Small Business Innovation Act of 1981. |
| Full | May 15, 1981 | Open hearing on the Small Business Administration's Disaster Loan Programs and Other Cost Saving Proposals (S. 865, S. 945, and S. 987). |
| Advocacy and the Future of Small Business Subcommittee. | June 24, 1981. | Open hearing on Government Competition with Small Business. |
| Innovation and Technology Subcommittee | June 30, 1981. | Open hearing in Boston, Massachusetts, on S. 881, the Small Business Innovation Research Act of 1981. |
| Full | July 14, 1981. | Open hearing on the Deterioration of the U. S. Defense Industrial Base. |
| Innovation and Technology Subcommittee | July 15, 1981<br>July 16, 1981 | Open hearing on S. 881, the Small Business Innovation Act of 1981. |
| Full | July 24, 1981 | Open hearing on S. 881, The Small Business Innovation Research Act of 1981, San Francisco, California. |
| Full | July 30, 1981 | Open hearing on the Confirmation Hearing of Frank S. Swain, to be Chief Counsel for Advocacy of the Small Business Administration. |
| Productivity and Competition Subcommittee | Aug. 14, 1981 | Open hearing on the effects which ERISA and MPPRA have had on the Competitiveness of Small Business, Seattle, Washington. |
| Advocacy and the Future of Small Business Subcommittee. | Aug. 27, 1981 | Open hearing on Government Competition with Small Business, Los Angeles, California. |

### CHRONOLOGICAL LIST OF HEARINGS—Continued

| FULL COMMITTEE OR SUBCOMMITTEE | DATE | SUBJECT |
|---|---|---|
| Full | Sept. 9, 1981<br>Sept. 10, 1981 | Open hearing on SBA's Farm Disaster Loan Program. |
| Full | Sept. 21, 1981 | Open hearing on S. 1620, SBA's 8(a) Pilot Procurement Program |
| Full | Sept. 23, 1981<br>Sept. 24, 1981 | Open hearing on Interest Rates and Business Credit Needs. |
| Urban and Rural Economic Development Subcommittee. | Oct. 5, 1981 | Open hearing on Industrial Development Bonds (IDB's). |
| Full | Oct. 13, 1981 | Open hearing on the Problem of Interest rates: causes, consequences, and outlook, Hartford, Connecticut. |
| Full | Oct. 14, 1981 | Open hearing on the problem of interest rates: causes, consequences, and outlook, New York City, New York. |
| Full | Oct. 19, 1981 | Open hearing on interest rates and business credit needs, Memphis, Tennessee. |
| Full | Oct. 27, 1981 | Open hearing on Small Business Administration's Direct Loan Programs. |
| Advocacy and the Future of Small Business Subcommittee. | Nov. 4, 1981 | Open hearing on Government Competition with Small Business. |
| Productivity and Competition Subcommittee | Dec. 1, 1981 | Open hearing on Federal Antitrust Policy: Implications for Small Business. |
| Subcommittee on Government Procurement | Feb. 2, 1982 | Open hearing on The Impact of the Davis-Bacon Threshold on Small Business Construction Contractors. |
| Advocacy and the Future of Small Business Subcommittee. | Feb. 17, 1982 | Open hearing on the Small Business Utilization of the *Commerce Business Daily*, San Diego, California. |
| Full Committee | Feb. 19, 1982 | Open hearing on the Small Business Administration's Timber Set-Aside Program, Ho |
| Full Committee | Feb. 23, 1982 | Open hearing on the Small Business Administration's Budget for Fiscal Year 1983. |
| Full Committee | Feb. 25, 1982 | Open hearing on Influencing Small Business Investment in Enterprise Zones. |
| Full Committee | Mar. 2, 1982 | Open hearing on Safe Harbor Leasing: Usability by Small Business. |
| Full Committee | Mar. 4, 1982 | Open hearing on S. 1947, a Bill to Improve Small Business Access to Federal Procurement Information. |
| Full Committee | Mar. 9, 1982 | Open hearing on the Nomination of James C. Sanders to be Administrator of the Small Business Administration. |
| Full Committee | Mar. 11, 1982 | Open hearing on the Small Business Administration's Surety Bond Program. |
| Full Committee | Mar. 31, 1982 | Open hearing on The State of Small Business: A Report of the President. |
| Full Committee | Apr. 5, 1982 | Open hearing on Influencing Small Business Investment in Enterprise Zones, Oakland, California. |
| Full Committee | Apr. 7, 1982 | Open hearing on Influencing Small Business Investment in Enterprise Zones, Chicago, Illinois. |

CHRONOLOGICAL LIST OF HEARINGS—Continued

| FULL COMMITTEE OR SUBCOMMITTEE | DATE | SUBJECT |
|---|---|---|
| Full Committee | May 7, 1982 | Open hearing on Influencing Small Business Investment in Enterprise Zones, St. Paul, Minnesota. |
| Full Committee | June 23, 1982 | Open hearing on Minority Business and Its Contributions to the U.S. Economy. |
| Government Regulation and Paperwork Subcommittee (SSBC) and Regulatory Reform Subcommittee (Jud. Com.). | Aug. 12, 1982 | Jt. hearing on Oversight of the Regulatory Flexibility Act. |
| Urban and Rural Economic Development Subcommittee. | Aug. 16, 1982 | Open hearing on The Impact of Crime on Small Business, New York, N.Y. |
| Export Promotion and Market Development Subcommittee. | Aug. 19, 1982 | Open hearing to Consider the Obstacles Faced by Small Business Exporters. |
| Full Committee on Small Business and Subcommittee on State, Justice, Commerce, The Judiciary and Related Agencies, Committee on Appropriations. | Sept. 9, 1982 | Jt. hearing on Federal Antitrust Enforcement and Small Business. |
| Full Committee | Sept. 16, 1982 | Open hearing to Consider S. 2446, and Other Small Business Procurement Reforms. |
| Urban and Rural Economic Development Subcommittee. | Sept. 28, 1982 | Open hearing on SBA's Economic Development Programs. |
| Full Committee | Oct. 12, 1982 | Open hearing on Current Petroleum Marketing Practices and Their Impact on Small Business, Chicago, Illinois. |
| Urban and Rural Economic Development Subcommittee. | Sept. 16, 1982 | Open hearing on The Impact of Crime on Small Business, Albany, N.Y. |
| Full Committee | Oct. 18, 1982 | Open hearing to Explore the Effect of Crime on the Economic Climate of New York. |
| Full Committee | Oct. 21, 1982 | Open hearing on Obstacles to Exporting Faced by Small Business. |
| Urban and Rural Economic Development Subcommittee. | Nov. 15, 1982. | Open hearing on The Impact of Crime on Small Business, San Francisco, Calif. |
| Full Committee on Small Business and Subcommittee on Tax, Access to Equity Capital and Business Opportunities, House Small Business Com.. | Dec. 1, 1982 | Jt. hearing on the Recommendations of SEC Government-Business Forum on Small Business Capital Formation. |
| Productivity and Competition Subcommittee | Dec. 8, 1982 | Open hearing on Oversight of the Economic Problems Facing Small and Independent Businesses in the Forest Products Industry. |
| Full Committee | Dec. 16, 1982 | Open hearing on Oversight of Small Business Administration's SBIC Programs. |

## APPENDIX D

## Publications of the Committee on Small Business, 97th Congress

### HEARINGS

Jan. 23, 1981 — Small Business Administration 8(a) Pilot Program.

Mar. 9, 1981 — The Role of Small Business in the Nation's Economic Recovery.

Mar. 13, 1981 — To Consider and Report to the Senate Budget Committee Recommendations for Small Business Administration Programs.

Mar. 23, 1981 — Nomination of Michael Cardenas to be Administrator of the Small Business Administration.

Apr. 27 and 28, 1981 — Small Business Administration's Contracting Procedures.

May 5, 1981 — Small Business Administration's Size Standards.

May 7, 1981 — Small Business Administration's Pollution Control Bond Guarantee Program and S. 580, A Bill to Increase Its Program Levels.

May 13, 1981 — S. 881, The Small Business Innovation Research Act of 1981.

May 15, 1981 — SBA's Disaster Loan Programs and Other Cost-Saving Proposals.

Jun. 24, Aug. 27, and Nov. 4, 1981 — Government Competition With Small Business.

Jul. 30, 1981 — Nomination of Frank S. Swain to be Chief Counsel for Advocacy of the Small Business Administration.

Jun. 30, Jul. 15, 16, and 24, 1981 — S. 881, The Small Business Innovation Research Act of 1981.

Jul. 14, 1981 — Deterioration of the U. S. Defense Industrial Base.

Aug. 14, 1981 — The Effects Which ERISA and MPPRA Have Had on the Competitiveness of Small Business.

Sept. 9 and 10, 1981 — SBA's Farm Disaster Loan Program.

Sept. 21, 1981 — SBA's 8(a) Pilot Procurement Program.

Oct. 5, 1981 — Tax-Exempt Industrial Development Bonds.

Dec. 1, 1981 — Federal Antitrust Policy: Implications for Small Business.

Feb. 2, 1982 — The Impact of the Davis-Bacon Threshold on Small Business Construction Contractors.

Feb. 17 and Mar. 4, 1982 — To Consider S. 1947, A bill to improve Small Business Access to Federal Procurement Information and Small Business Utilization of the Commerce Business Daily. (San Diego, Calif. & Washington, D.C.).

Feb. 19, 1982 — Timber Set-Aside Programs, (Hot Springs, Ark.).

Feb. 23, 1982 — To Review SBA's Budget Authorization for Fiscal Year 1983.

Feb. 25, Apr. 5 and 7, May 7, 1982 — Influencing Small Business Investment in Enterprise Zones. (Washington, D.C., Oakland, Calif., Chicago, Ill., and St. Paul, Minn.)

Mar. 2, 1982 — Safe Harbor Leasing: Usability by Small Business.

Mar. 9, 1982 — Nomination of James C. Sanders to be Administrator of the Small Business Administration.

Mar. 11, 1982 — Small Business Administration's Surety Bond Guarantee Program.

Mar. 31, 1982 — The State of Small Business: A Report of the President.

Jun. 23, 1982 — Minority Business and Its Contributions to the U.S. Economy.

Aug. 12, 1982 — To Oversee the Regulatory Flexibility Act and to Consider S. 2170.

Aug. 19, and Oct. 21, 1982 — To Consider the Obstacles Faced by Small Business Exporters. (Washington, D.C., and Spokane, Wash.)

Sept. 9, 1982 — Federal Antitrust Enforcement and Small Business.

Sept. 16, 1982 — To Consider S. 2446, and Other Small Business Procurement Reforms.

Sept. 28, 1982 — SBA's Economic Development Program.

Oct. 12, 1982 — Current Petroleum Marketing Practices and Their Impact on Small Business. (Chicago, Ill.)

## REPORTS ON BILLS

**S.Rept. 97-194** **Sept. 25, 1981**

Small Business Innovation Research Act of 1981 (To accompany S. 881)

**S.Rept. 97-195** **Sept. 28, 1981**

Amending Section 8(a)(1) of the Small Business Act (To accompany S. 1620)

**S.Rept. 97-399** **May 18, 1982**

Amending Section 8(c) of the Small Business Act (provisions relating to the notice of Federal Procurement actions) (To accompany S. 1947).

**S.Rept. 97-400** **May 18, 1982**

Small Business Venture Capital Act of 1982 (To accompany S. 2408).

## COMMITTEE PRINTS

Feb. 18, 1981 — Small Business Issues and Priorities — 1981.

Jun. 10, 1981 — Executive Summary. The Small Business Administration's Size Standards, Based on a Hearing Before the Committee of May 5, 1981.

Oct. 28, 1981 — First Meeting of the Committee on Small Business, United States Senate, with Members of the Committee's National Advisory Council.

Feb. 1, 1982 — Review of the Committee's Activities in the First Session of the 97th Congress.

Apr. 22, 1982 — Second meeting of the Committee on Small Business, United States Senate, with Members of the Committee's National Advisory Council.

## APPENDIX E

## "The State of Small Business" - A Report of the President

To the Congress of the United States:

The success of the American economy is critically dependent upon preservation of real opportunity for small business. Historically, small business has provided much of the growth in jobs and innovation as well as being the supplier of services and deliverer of goods to virtually every farm, village, town and city in our nation. Although there are many definitions of small business, the one agreed upon by the 1980 White House Conference on Small Business was that of businesses employing 500 employees or less. Currently, approximately 15 million businesses, or 99 percent of the total number of businesses, fall into this category.

Small businesses are a complex mixture of a wide variety of ownership types, sizes and location. Published statistics from the Internal Revenue Service show that most small businesses are sole proprietorships. Still, significant numbers of partnerships and corporations are also small. Bureau of the Census statistics show that small businesses appear in all industry categories: manufacturing, transportation, insurance, wholesale and retail trade, and every other kind of industry. Small businesses vary in size: many have no employees (reflecting either family owned and operated or individually owned and operated businesses); over two million have between one and 20 paid employees. They are located all across our nation; many are in our large cities but a significant portion are in small towns. In truth, our small businesses are as diverse and desparate as our population.

This Administration is committed to assuring unrestricted access for small businesses to all segments of our economy. By unleashing small business from the burdens of unnecessary taxation and regulation, we enable men and women small business owners to increase their contributions to our society's economic and employment growth. In addition, we will continue to help expand the opportunities of today's struggling business aspirants, disadvantageed ethnic and racial groups, and to blend their skills and abilities in creating a better life for themselves and a stronger America.

It is the objective of this statement to describe how this Administration is establishing an economic environment conducive to small business formation and growth. It first describes the economic contributions of small business. Second, it explores the foundation of this Administration's small business policies. And last, it examines problems and policies of special interest to small business.

### I. The Role of Small Business in the Economy

The roots of the American economy are to be found in the history of small business. In America's early years virtually all businesses were small. It was not until the advent of the industrial revolution in this country that large businesses emerged to take advantage of economies of scale in production, distribution, and marketing. Since the 19th century, the share of our national output of goods and services accounted for by small business has declined. The decline leveled off during the 1950's, with small business responsible for producing just over half of all private production. In the early 1960's, small business' share began another decline, and today it is responsible for slightly less than half of the production of goods and services in our economy. Clearly, the recent turmoil experienced by our economy also has taken a toll on the fortunes of small business.

Despite these trends, small business plays a key role in the U.S. economy. The contributions of small business to innovation and employment have been particularly noteworthy. In 1976, research for the National Science Foundation showed small business had been a more prolific source of innovations per research and development dollar than medium or large business. Inventors have often chosen to market their innovations through small business. Small business is, after all, ideally suited for such ventures by virtue of its greater flexibility and greater willingness to assume substantial risks in the pursuit of potentially large rewards.

Most small firms are labor-intensive, and over half of our labor force is currently employed by small businesses. Small businesses remain among the leaders in employment creation. According to research at the Massachusetts Institute of Technology, between 1969 and 1976, more than 86 percent of new jobs were provided by small businesses employing fewer than 500 employees. Some 80 percent of new jobs were provided by firms having 100 employees or less. Almost 66 percent of the new jobs were provided by businesses with fewer than 20 employees, and of the jobs provided by small businesses, 75 percent were attributable to firms that were less than five years old.

Small business has also played an important role in providing economic opportunities for minorities and women, both as employees and as entrepreneurs. Minority-owned business enterprises are predominately small businesses. Minorities control about 4 percent of all businesses and are concentrated in industries affording easy entry such as retail trade, services, and construction. Women control about 5 percent of all businesses and are also in those industries affording easy entry.

Given our nation's economic difficulties, we cannot afford to ignore the resources and potential contributions of small business enterprises. Their innovative spirit, their flexibility to meet new challenges, are crucial to our economic progress. At the same time, the employment and entrepreneurial opportunities presented by this sector are too important to be less than fully realized. The bottom line is quite straightforward: America needs small business formation and growth.

## II. The Foundation of Small Business Policy

The basic problem of the United States economy is that it is not growing fast enough. Since 1973, the U.S. economy has grown at a real rate of less than 2.4 percent, barely two-thirds of the 3.8 percent real growth rate experienced from 1950 to 1973, and far below the 4.5 percent rate achieved between 1962 and 1969. Why are we not growing? An important reason is that sources of growth have been obstructed by past Federal policy errors. These errors involve the tax code and its interaction with inflation, the excessive appropriation of resources by the government and distortions in the use of resources by unwise government intervention in the workings of the free market.

The fundamental tenets of small business policy are thus quite clear. Government should promote a strong, vibrant, private economy with policies that primarily rely upon free market forces to organize and allocate our economic resources. Economic growth and full employment must be restored while reducing inflation and interest rates, and, at the same time, Federal impediments to the free and efficient use of resources must be reduced or eliminated. The end result should be an economy characterized by free and open markets giving all of its participants the opportunity to contribute to, and share in, the high and rising standard of living such a system will produce.

### The Economic Recovery Program

The cornerstone of our initiative for the small business sector is our four-part Economic Recovery Program. No other set of actions by this government is a likely to correct the errors of the past and have such a pervasive and lasting positive effect on small business. It consists of the following:

1. A cooperative effort with the independent Federal Reserve Board to achieve a moderate and steady monetary policy to end inflation. Our goal is to reduce high interest rates and remove disincentives produced by the interaction of inflation with the tax code.

2. A regulatory reform program to reduce the inefficiencies and enormous costs that are holding back production and raising prices.

3. An incentive-oriented tax policy designed to increase work effort, savings, and investment.

4. A stringent budget policy designed to return resources to the private sector for investment and growth.

Monetary policy has been aimed primarily at reducing inflation. Our goal is a moderate and steady growth of the money supply at rates consistent with stable prices. The excessive money growth of the 1970's has left us with double digit inflation. That inflation has increased interest rates to record levels. Lenders have had to add an inflation premium to the real interest rate in order to protect their principal from erosion. They have also had to add a risk premium to compensate for the increased uncertainty of sharp and sudden policy changes and wild market swings such as have occurred in the past three years.

Generally high interest levels, coupled with wide swings in interest rates, have been a source of special concern for small business. More stable monetary policy is needed to make financial markets more predictable an to prevent discontinuities in the availability of capital. This will result in lower, less volatile interest rates.

Regulatory relief is needed to reduce unnecessary costs imposed by government. Government regulations, including paperwork, have become a major source of market interference, reducing competition and efficiency within most industries. Moreover, regulations often have disproportionately adverse effects on small businesses, and the result is all too frequently an impaired ability of small businesses to compete effectively.

Fiscal policy has been aimed at promoting real growth. Lower production costs and more goods on the shelves help combat inflation, but the main purpose of the tax and spending reduction is to improve the incentives by raising marginal tax rates on individuals and businesses, thereby reducing the rewards to labor and capital. Both the business and personal tax reductions in the Economic Recovery Tax Act of 1981 (ERTA) are essential elements in restoring these rewards to promote growth.

Small business will benefit from the general individual tax rate reductions and the indexing of tax brackets after 1984. Millions of small businesses are partnerships, proprietorships and Subchapter S corporations, the income from which is taxed at personal rates. In addition, the personal rate reductions will help restrain increases in labor costs, a prime concern of labor-intensive small businesses. Small businesses will benefit from other features of the ERTA as well. Among the more important provisions will be the Accelerated Cost Recovery System, the ability to expense limited amounts of depreciable assets, increases in the Investment Tax Credit for unused property, lower corporate tax rates for small businesses, increases in the allowance for accumulated earnings, and simplified last-in-first-out (LIFO) inventory accounting. The estate tax reduction in ERTA significantly enhances the ability of small, family-owned enterprises to be perpetuated beyond the present generation, instead of being liquidated to meet excessive estate tax obligations. Other important provisions include the expansion of the funding limitations of the Keogh Plan and individual retirement accounts (IRAs). These provisions are helpful to small business in that they allow for increased tax deductions for the more profitable businesses, and at the same time generate more capital for institutions to lend to small business.

Spending restraint is needed to return the real and financial resources now being absorbed by the government to the private sector for use in investment and growth. The capital needs of the private sector, and of small business in particular, have been squeezed by the growth of the government sector. The problem manifests itself most directly in the competition for funds in the credit market, where the growing deficits must be financed.

Deficits are the evidence of the deeper problem of growth of the public sector. When purchases and financial claims of government increase relative to Gross National Product (GNP), it means fewer real and financial resources are available for use by the private sector to expand capacity and production. Improving access of small business to needed resources requires curtailing this government preemption of the country's work force, capital goods, raw materials, and productive capacity, as well as credit. Government spending "crowds out" the private sector's access to these resources whether that spending is financed by taxes or borrowing.

## III. Problems and Policies of Particular Interest to Small Business

### Cyclical Sensitivity

By the very nature of their structure, resources, and to some extent the types of activities in which they participate, small firms tend to be highly susceptible to the ups and downs of overall economic activity. Small businesses have fewer resources than large businesses to survive cyclical downturns and are more likely to fail.

Return of economic growth, coupled with substantial moderation of inflation expected from implementation of our economic program, is therefore of particular interest to small business. In addition, reduction of the uncertainties associated with wide swings in Federal economic policy should result in a business climate more conducive to formation, growth, and success of small business ventures. Stabilization will pay dividends for us all but most particularly for small businesses because of their greater susceptibility to business cycles.

### Inflation

For the men and women who own small businesses, inflation is a particularly serious problem. It earns this distinction essentially by exacerbating the other problems of small business, such as need for capital, the cost and availability of investment funds, and increased uncertainty concerning the behavior of the economy and The posture of economic policies. Small businesses often are in competitive markets where they tend to have little control over the costs they must pay and the prices they are able to charge, leaving them especially vulnerable to adverse price movements.

The economic program of this Administration should provide small business with relief from inflation in several ways.

first, adherence to a policy of stable and limited monetary growth should eliminate the primary engine of inflation in our economy. Second, the improved incentives and reduced labor costs flowing from the reduction in Federal personal income tax rates should result in improved labor productivity, a matter of great importance to small businesses, given their tendency to be labor-intensive. Finally, help in controlling other costs of doing business will be derived from the elimination of unnecessary and inefficient regulatory burdens. Taken together, therefore, our policies should reduce the extent of the inflation problem at the same time the ability of small businesses to cope with the inflation problem is being enhanced.

## Interest Rates

Interest rates are also a very serious problem for small business. High interest rates cause severe cash flow problems which are particularly threatening to small businesses. The heightened sensitivity to high and volatile interest rates stems from the tendency of many small businesses to be undercapitalized and/or to be facing substantial capital needs to finance growth. the volatility of interest rates associated with the higher levels also works a hardship by raising the risk associated with investment and growth. The cost of the capital is a significant cost of production, and wide swings in interest rates are easily capable of producing ruinous cost structures for small businesses. Moreover, the deductibility of interest expense is of less help to small businesses since they frequently generate insufficient income (particularly new ones just starting up operations) to take full advantage of the tax deduction.

As stated earlier, the key to lower, steadier, interest rates is a consistently lower rate of inflation. When the inflation rate is high, interest rates are pushed up directly by the need for an inflation premium to protect the real value of the loaned funds. In addition, the economic instability suggested by the presence of high rates leads to a larger risk premium as well. Because interest rates are clearly influenced by inflation, and because the rate of inflation depends heavily upon the growth rate of money, major improvement is expected through our policy of moderate growth of money and credit. Short term movements in interest rates may evidence little progress at first, as was illustrated early in the summer of 1981, but continued easing of inflation is evidence that conditions will improve as this policy is more firmly established.

## Access to Capital

There are many impediments reducing access to adequate capital, and unfortunately some of these work to the particular detriment of small business. Saving in recent years has been depressed by the interaction of inflation and the marginal tax rates. Inflation pushes taxpayers into higher income brackets which are subject to progressively higher rates of taxation. The result has been reduced incentives to save and work. Small business has suffered not only from the general lack of saving, but also because entrepreneurs have historically looked to family and friends to supply the equity investment funs used as seed capital to form new businesses. When saving becomes difficult, these sources are materially diminished.

Small businesses also operate under something of a handicap in the competition for business funds. As mentioned earlier, small size translates into somewhat greater vulnerability, thus raising the risk associated with any given investment in a small business. In addition, economies of scale tend to preclude small business participation from the more impersonal mechanisms of our financial system. Registration requirements associated with the public issuance of stock, for example, can only be afforded if the cost is spread over a large number of shares. In the same vein, loans from insurance companies, large banks, and other major sources of investment capital are rendered by the prospective lenders. Access of small businesses to investment capital is thus frequently limited to individuals and small banks which have a personal relationship with the entrepreneur.

Unfortunately, depressed saving rates and limited access are not the only problems. The past tendency of the Federal government to rapidly expand its claims on resources caused either the reduced saving rates when those claims were financed by taxation, or became a direct, competing claim on available saving if financed through deficits. That is, deficits themselves absorbed funds that would otherwise have been available for investment, making all access points to the flows of financial capital less able to meet the demands placed upon them by the private sector. Since small businesses have had relatively few access points, their hardship has been particularly acute.

The most fundamental policy to improve small business access to capital is the reduction of the governmental claims on resources expressed in the drive to curtail government spending. Spending restraint is the key element since either high taxes or borrowing would reduce the resources available to the private sector for the investment and growth.

Understanding the implications of the deficits projected for the next few years, however, is somewhat more complex. The deficit alone does not determine the amount of crowding out taking place in the financial market. What matters is the relationship between the deficit and the supply of savings needed to finance it. The first thing to note, therefore, is that the recently enacted tax reductions and the new higher Keogh Plan and IRA allowances will provide a powerful stimulus to saving. Business tax reduction for 1982, for example, will increase business saving; this is money that business will not need to borrow from financial markets. Personal tax reduction should promote substantial reallocation of income from consumption to saving, in addition to the normal saving increase from income growth alone. Year-over-year, there should be an increase in total private savings from 1981 levels in excess of 60 billion dollars.

The Economic Recovery Tax Act will improve small business access to capital in other ways as well. For example, the amount of earnings which may be retained in closely held corporations without being penalized by the accumulated earnings tax has been increased from $150,000 to $250,000. The change makes it possible for the men and women who own small firms to accumulate a larger amount of investment capital without incurring an accumulated earnings tax. Another feature of ERTA is an increase in the maximum number of shareholders in Subchapter S corporations from 15 to 25 plus allowance of certain kinds of trusts to be treated as shareholders in such corporations. The provisions strengthen the attractiveness and utility of the Subchapter S provisions.

Still, the pressing need among many businesses is for equity capital, not debt. Repayment burdens of large loans, regardless of whether government or private in origin, inhibit the growth and formation of new businesses, especially those owned by women and minorities.

We recognize the need that small business has for new mechanisms of constructive finance. We also recognize that some of the mechanisms available, such as participating debentures, may require accommodative tax changes if they are to be effective.

Federal economic and financial policy plays a crucial role in small business viability. Thus, it is important that the Federal departments involved in these areas be consistently sensitive to small business needs. I am directing the Commissioner of the Internal Revenue Service to include representatives of small business in advisory groups which review administration of tax system.

Changes in Federal policy affecting financial institutions will also take into account the impact on small business needs. The trend of Federal financial reform movements has been toward providing a broader array of sophisticated financial services from strengthened and modernized institutions of all types in a competitive and cost minimizing market. These reforms should continue to insure further gains in services for depositers and borrowers of all sizes, at lowers possible cost, throughout the country as well as in financial centers. The result may well be the creation of important new access points for small business in the flows of investment capital.

## Tax Incentives

The Economic Recovery Tax Act seeks to provide incentives to increase asset purchases as well as to encourage employment growth. Small business has less than one-fourth of total business assets, but employs over one-half of the work force. Asset-based tax incentives will provide some direct economic stimulation to small business.

As noted earlier, general reductions in the marginal personal income tax rates and tax indexing will be beneficial for small businesses. Since most small firms are labor-intensive, their cost structures should benefit as the impact of the tax reduction helps restrain increases in labor costs. By reducing, if not eliminating, bracket creep, indexing will also moderate employee wage demands. Improvements in wage cost pressures will be realized by big businesses as well, but the labor intensive character of small businesses means this provision will be even more important in their case.

Small business will also benefit from the Accelerated Cost Recovery System included in ERTA. The direct share of this benefit going into small business, while important, may be relatively small since these firms use less depreciable property per dollar of sales. On the other hand, to the extent small businesses are suppliers to large capital intensive firms (and in many cases are producers of depreciable assets themselves), the capital investment favoring provisions of ERTA should improve the market and profit positions of major parts of the small business sector, e.g. firms in the construction industry.

Within ERTA there is also an extensive list of special provisions targeted specifically to small business. Small Businesses will benefit from the lower tax rates on the two lowest income brackets, the simplification of LIFO inventory accounting, the increased allowance for accumulated earnings, more liberal treatment of stock option plans, the liberalization of Subchapter S provisions, expanded expenses of depreciable assets, the larger allowance for the investment tax credit on used property, and the expanded funding allowances on Keogh plans and IRAs. And family owned and closely held small business owners are assured of community ownership through the liberalized estate and gift tax laws. The aggregate amounts of the tax relief afforded by these tax provisions can involve significant reductions in marginal tax rates and thus provide powerful incentives for growth and development.

## Regulation

Major increases in business regulation began during the last decade. The Occupational Safety and Health Act, the national Environmental Protection Act, the Employee Retirement Income Security Act, and others, have served important national objectives but have also introduced distortions in the operations of the free market, impeded competition, and increased costs of the regulated businesses. Most of these regulations have stipulated the same compliance requirements for small business as for large corporations. The relative burden is much greater, however, because compliance costs cannot be spread over larger quantities of output. In short, small business has found itself at a competitive disadvantage because of the existence of efficiencies of scale in regulatory compliance.

The problem is a particularly difficult one. On the one hand, regulations frequently address important social objectives which cannot be dismissed lightly. On the other hand, their application to small business is frequently of only marginal importance to the social objectives involved, or they are applied in ways which are inappropriate in a small business context.

Nevertheless, difficult as the job may be, this Administration is committed to a major effort in regulatory reform. The problem has been approached with a two-pronged effort: regulatory relief and use of regulatory flexibility. So far regulatory relief has been the major policy tool. During the first year, regulatory relief has been actively pursued in every regulatory agency and the number of new regulations has been significantly reduced.

The Presidential Task Force on Regulatory Relief has announced a number of existing regulations for in-depth Federal agency review which are considered by small businesses to be most onerous. Agencies will be expected, following their review, to propose changes in these regulations in order to lessen the regulatory burdens of America's small businesses. It also is timely to accelerate the review of all existing regulations imposed on the business sector to determine whether maximum flexibility is being provided to accommodate the uniqueness of small businesses. Legislation enacted by the last Congress, the Regulatory Flexibility Act provides the mechanism for undertaking this effort. The objective will be to assure that existing regulations do not unnecessarily impede growth and development of small businesses. At the same time, we will keep in place those regulations that are beneficial to society -- such as health and safety in the work place, and a healthy environment.

Full utilization of the provisions of the Regulatory Flexibility Act will be a principal theme of our regulatory reform efforts over the next three years. I will direct each Federal department and agency to accelerate the time for completion of the review of existing regulations as specified in the Regulatory Flexibility Act from ten to five years.

Regulatory flexibility may not be adequate to deal with the regulatory relief efforts that we have already launched in the areas of banking and finance. It is important that the interests of small business be given special attention. I am directing the Controller of the Currency and asking the Chairman of the Federal Home Loan Bank board, the Federal Deposit Insurance Corporation, and the Federal Reserve Board to follow the Regulatory Flexibility Act guidelines for assessing the small business impact of their proposals for changing our financial institutions.

The Securities and Exchange Commission has already established an admirable record of proposing regulatory reform that will allow small business men and women to meet their equity capital needs more cheaply and easily through the issuance of equity securities. I encourage them to continue their activities.

In summary, four economic problems plague small business, cyclical sensitivity, inflation, interest rates and access to capital. We addressed these problems with our four part economic recovery program: Federal spending cuts, tax reforms, regulatory relief and stable monetary policy. The results are beginning to show -- substantial decline in inflation, a start toward long-term decline in interest rates and increases in savings to expand the supply of capital. This is not the time to deviate from our program. We are breaking the back of stagflation. We have a solid economic program and we reject pleas for "quick fixes" like those used in the past. Our program will pull us out of this slump and put us on the road to prosperity and stable growth by the latter half of this year.

## Antitrust

Small businesses rely upon the free functioning of markets to compete and prosper. Our antitrust laws -- the Sherman and Clayton Acts -- protect the competitive markets upon which our free enterprise is based. The ability of our economy to remain free of illegal and anticompetitive practices is properly a major concern of small business.

Frequently, levels of concentration are considered an inverse barometer of the health competition and the small business community. The concentration problem, however, may be somewhat less than meets the eye. One type of concentration, aggregate concentration (the extent to which productive assets, across all industries, are held by a limited number of firms of large size), has not been adequately documented because the statistics are less than perfect reflections of the exercise of control over establishments across industrial groupings.

Another type of concentration, market, or industrial, concentration (the extent to which total sales of a particular industry are concentrated in several or a few producers), may occur naturally where producers find economies of scale in production, distribution or marketing. History also reveals that market concentration has waxed and waned in many industries depending upon developments in technology.

There are numerous weaknesses in the statistics bearing on the concentration question. For one thing, they vary tremendously from industry to industry; the service sector is more concentrated and shrinking (as a share of GNP). Generalizations about market power are therefore quite difficult. Existing statistics on concentration ratios also tend to focus on manufacturing, ignoring the service, construction, and other sectors where small businesses predominate.

At the theoretical level it is also legitimate to question whether concentration ratios are, in fact, reasonable indicators of the degree of market power being wielded by the participants. Market power is, after all, determined by the availability of acceptable substitutes, barriers to entry, and the practical geographic limits of the market area. The sole dry-cleaner in a small remote town, for example, could conceivably exercise more market power than a major auto manufacturer facing international competition. In the final analysis then, it must be recognized that concentration ratios tell us very little about the competitiveness of the markets within which small businesses operate.

Antitrust policy in general, and particularly merger policy, is the specific context in which the Federal government protects the economy from illegal combinations of market power. The interests of small business are best served by an economically sensible and clearly stated merger policy that carefully examines each specific transaction, and inhibits those transactions that clearly threaten to restrain competition. The Attorney General will vigorously prosecute anticompetitive behavior -- including, where appropriate, the use of criminal sanctions -- to protect competition and eliminate artificial barriers to entry. To the extent that Federal antitrust enforcement can influence competition, this Administration will use its enforcement powers consistently and without hesitation.

This Administration also recognizes that there is a variety of economic and governmental factors which contribute to the competitive capability of small business and perhaps influence the levels of concentration observed in the economy. Tax, regulatory, and fiscal policies appear particularly critical, and are areas over which the Federal government has major influence. Our primary mission in restoring a healthy economy and the premium for hard work and entrepreneurship, is to ensure that the unconcentrated small business sectors can continue to grow.

## Research and Development, and Innovation

Innovation by independent, small firms is central to a natural reduction of industrial concentration. The Federal government is the largest single purchaser of industrial research and development in our economy. Until recently, government purchased more research and development than all other buyers combined.

In its pursuit of efficiency in research and development procurement, the government has gradually concentrated its purchases in larger firms and universities. As government budgets have become tighter, procurement officers have found it more immediately efficient to spend research and development funds in fewer large contracts rather than many small contracts. At a minimum, we need to assure that the internal efficiency achieved by such procurement practices are justified since the continuation of these practices will inevitably lead to increasing market concentration, at least among suppliers of contract research and development. Last fall, I indicated my support for Senate Bill 881, the Small Business Innovation Research Act, as it was passed by the Senate, I call upon Congress to pass this Bill for my signature this year.

For small business firms, cash availability is a serious limitation on the amount of research and development they can undertake. The Economic Recovery Tax Act provides an incentive for research and experimentation by allowing a 25 percent tax credit for certain research and experimentation expenditures in excess of a three-year moving average base period. The credit will be in addition to the immediate expenditures permitted under present law. Thus, small businesses' ability to finance their own programs should be materially improved.

I have also requested the Attorney General to examine antitrust laws to ensure that they do not interfere with the ability of patent and copyright holders, including those in the small business sector, to reap the proper rewards for their innovative contributions.

## Federal Procurement

The phrase "industrial policy" has come to mean some form of elaborate industrial planning. But our industrial policy is one of establishing and maintaining competitive markets. We remain convinced that this policy will encourage and support the viable small business sector of our economy. Consistent with his philosophy, the Administration is taking steps to encourage competition in the Federal sector.

### Government Policy of Not Competing with Private Industry.

The Administration has made a major priority the policy of withdrawing wherever possible from competition with private industry in providing goods and services to be used by the Federal government. Activities of all departments and agencies are being examined to see which can be converted to the private sector. For instance, in a review of 440 activities conducted by military departments, it was found that 264 of these, or 60 percent, could be turned over to private sector enterprise. As these and other requirements are filed by the private sector rather than government itself, a principal beneficiary will be small business.

### Prompt Payment on Government Contracts.

The Administration is taking action to ensure that payments are made promptly to Federal contractors. Small business contractors are least able to wait for payment and will gain the most from prompt payments by the government. Accordingly, we have directed that all government contracts contain clear and specific instruction as to the procedure to be followed to obtain prompt payment. Further, contracts must now state precisely when the contractor can expect to be paid. Additionally, one of the criteria we will be using to evaluate Federal employees who are involved in the payment process will be their performance in paying government vendors promptly. Again, the Administration strongly believes that Federal contract payments should be made on time. Also, we agree with the basic concept of authorizing through law the payment of penalty interest when the government unreasonably delays payment of a bill.

## Export

Export trade plays a vital role in our economy. In part, it brings social benefits of our society's technology to other nations of the world and it also benefits our people with increased employment and returns to investment and help pays for our imports. Unfortunately, small business has not participated in this activity to the fullest extent. Thus, our existing foreign trade promotion efforts must be more conscientiously targeted to small businesses to assist them in access to foreign markets. I am directing the Department of Commerce in cooperation with the Small Business Administration to emphasize programs that encourage export promotion among small businesses.

## Equal Business Opportunity

The Administration is committed to pursuing unrestricted access for all business persons to all segments of the economy. Clearly, women and minority community members represent the largest underutilization resource of economic activity in our nation today. We are committed to unleashing this potential by removing barriers to their participation in business ownership.

Capital availability for women and minority entrepreneurs continues to be a significant problem. This problem is being addressed at least partially by the Federal Trade Commission's recent actions to strengthen enforcement of the Equal Credit Opportunity Act.

Success of minority and women-owned business is dependent upon access to resources and knowledge of business management methods. The government has traditionally assisted minority and women business owners with management and technical assistance to help overcome social and prejudicial barriers.

In recognition of the importance of the minority business assistance programs, we have increased the program levels for SBA's Minority Small Business program and the Commerce Department's Minority Business Development Agency for fiscal year 1982 as compared to fiscal year 1981. In addition, we are proposing to Congress that these program levels be maintained in fiscal years 1983 and 1984. This includes activities such as financing for Minority Enterprise Small Business Investment Companies (MESBICs). In addition, the SBA will direct a larger portion of its guaranteed loans toward minority business owners.

We intend to expand the level of services delivered to the minority business community by improving the quality and effectiveness of service. To accomplish this, the Cabinet Council on Commerce and Trade is reviewing all government assistance programs for minority business to determine how they can be made more efficient and effective.

This Administration is dedicated to the systematic elimination of regulatory and procedural barriers which have unfairly precluded women from receiving equal treatment from Federal activities, including those activities affecting the opportunities of women in business. The Attorney General is systematically reviewing Federal laws and regulations in order to identify gender-based discrimination. He shall, on a quarterly basis, report his findings to me through the Cabinet Council on Human Resources. The Task Force on Legal Equity for Women, which I created recently by Executive Order, will then be responsible for implementing changes ordered by me.

In addition, we will ensure that the Women's Business Enterprise program in the Small Business Administration remains an effective and vital force advocating on behalf of present and potential women business owners. Also, the Office of Women's Business Enterprise will emphasize equal credit opportunity for women business owners.

## Small Business Data Base

Finally, it is apparent that the small business sector remains poorly documented in statistical. Existing Federal data derived from administrative records and data collection agencies are simply not adequate for policy analysis and decision making. Yet, we are committed to reducing the paperwork burden of small businesses and therefore reject any proposal to add data collection mechanisms to those currently in existence. At the same time, existing Federal data may be better organized and coordinated among agencies to help build a data base more suitable for small business policy making. To this end, the proposal for Federal agencies to compile statistics on business on a comparable basis will enhance analyses of the small business sector. We are planning for agencies to provide business size data on this uniform basis. Analysis of the small business sector would be furthered by sharing of selected data among statistical agencies, and we are examining ways of accomplishing this within the constraints of privacy and confidentiality commitments to small business, and provides policy relevant data. Thus, this data base must be continued and we have given it priority in our 1983 budget proposals. I am asking the Congress to enact my budget proposal for SBA's small business data base. Also, I am requesting the SBA to increase the resources allocated to this work and to include minority and women owned business data within its data base.

## IV. Summary and Conclusions

In conclusion, the importance of the small business sector cannot and should not be ignored. For me, small business is the heart and soul of our free enterprise system. The small business sector has played, and continues to play, an important role in the American economy. To help small business realize its full economic potential, this Administration is pursuing an economic policy aimed at getting the American economy growing again, together with programs designed to assure unrestricted access by everyone to economic resources and markets.

The essential parts of such an economic program are already in place. An effective mechanism for achieving regulatory reform has already been established. A policy of stable, moderate, monetary restraint must be followed. A fiscal policy calling for budgetary restraint coupled with important new tax incentives for work, saving, and investment is being put into practice. Moreover, within the context of this four part program, the major problems of particular interest to small business are being effectively addressed. These problems range from inflation, high interest rates, access to capital and regulation to research and development, export and equal business opportunities.

This statement and the following report are the first presented to Congress as required in Title III of Public Law 96-302. It has been prepared to meet both the letter and intent of the law and provide a comprehensive description of the state of small business. It is hoped the report will establish a spirit of cooperation with Congress to assist us in jointly pursuing economic growth and prosperity through our mutual recognition of the importance of small business in America.

RONALD REAGAN

## APPENDIX F

## Recommendations of the SEC Government-Business Forum on Small Business Capital Formation

### A. Developing Incentives to Institutional Investors And Others To Invest In Small Business

Recommendation (1) Congress should amend the Internal Revenue Code to provide for a "Small Business Participating Security", a hybrid form of security that would offer both a fixed rate of interest and a percentage of profit to the investors. Such a security would include such tax features as:

A. Capital gains treatment on the investors' profits;

B. Deductibility by the small business of both the profits and interest paid out by the business; and

C. An investment tax credit to the investor for such investment.

Recommendation (2) Congress should create a federally chartered, privately managed "Capital Bank" to provide a secure and stable source of continued funding for the Small Business Investment Company ("SBIC") program. A "Capital Bank" could have the following principal characteristics:

A. The Bank would be initially capitalized by the U.S. Treasury at the level of $100 million. This would represent a one-time, non-recurring investment by the Federal Government.

B. The Treasury investment would be retired over time out of profits earned by the Bank. The Bank's income would be derived from spreads on its loans, investment income and service fees.

C. SBICs would be obligated to purchase "participating" stock in the Bank.

D. The Bank would be authorized to issue its own securities (notes, debentures, stock) in conventional financial markets. These would be tax-exempt, backed by the SBIC debentures which the Bank had purchased and would be insured against loss by the Bank. The Bank would also be authorized to pool the SBIC debentures it purchased and sell participating interests in those pools. The pools would be structured so as to fall outside of the definition of an "investment company" under the Investment Act of 1940. The participating interests would have similar tax-exempt status and insured or guaranteed characteristics.

E. On a phased basis, the Bank would become an institution owned by persons in the private sector.

Recommendation (3) The $35 million ceiling on leverage to an SBIC should be removed.

Recommendation (4) Congress should amend Subchapter M of the Internal Revenue Code to provide conduit tax treatment for shareholders of business development companies.

B. Relaxing ERISA And Similar Regulatory Restrictions To Encourage Investment in Small Business

Recommendation (1) The Department of Labor, in conjunction with other appropriate government agencies, should disseminate to the fullest extent possible its position that investments by employee plans in smaller companies are not per se imprudent.

Recommendation (2) The Department of Labor should adopt a definition of the term "plan assets" under ERISA to permit venture capital managers to continue to invest pension plan funds without qualifying as plan fiduciaries and without venture pool assets qualifying as plan assets.

Recommendation (3) States should be encouraged to revise their public pension laws to permit investment of public pension assets in accordance with a flexible prudent person standard applied to the portfolio as a whole.

Recommendation (4) Pension funds and other institutions should be encouraged to utilize intermediaries experienced in small business financing in order to facilitate investment in small business.

C. Reducing Costs Associated with Securities Regulation

Recommendation (1) The SEC should exercise its jurisdiction:

A. Under Section 3(b) of the Securities Act to determine that no federal interest exists in offerings of less than $5 million by "Small Business Concerns" not required to be registered under Section 12 of the Securities Exchange Act at the time of the offering. "Small Business Concerns" should be defined to exclude (i) division or subsidiaries of non-exempt companies and (ii) tax shelter offerings.

B. To encourage a change in Section 12(g), by law or regulation, to increase materially the threshold criteria for registration, using net worth (shareholders' equity) as the test [suggested $5 million net worth and 2,000 shareholders].

Recommendation (2) The SEC should adjust the periodic reporting requirements for small businesses with a view toward simplification where appropriate. In particular, the SEC is urged to adopt a rule which permits an issuer which is neither listed on an exchange nor traded on the National Association of Securities Dealers Automatic Quotation System ("NASDAQ") to satisfy the Exchange Act reporting and proxy requirements if the issuer makes available to its security holders and files with the SEC:

A. Within 90 days after the end of its fiscal year, financial statements audited in accordance with GAAP for the last two fiscal years; and

B. 45 days after the end of each of its first three fiscal quarters, an unaudited financial statement in the same for as required for a 10-Q report.

Recommendation (3) The SEC could consider amending Form S-18 to permit its use for offerings of securities up to $10 million.

Recommendation (4) The Financial Accounting Standards Board ("FASB") and other interested parties should identify the critical aspects of financial information which lenders to and investors in small business need for investment and credit decisions. Those parties should insure that requirements for financial statements and disclosures are responsive to those needs, subject to the cost-benefit trade-offs of providing information.

Recommendation (5) The SEC should introduce the concept of "substantial good faith compliance in all material respects" into the exemptive scheme by amendments of existing rules and/or adoption of a new rule or rules to provide that substantial good faith compliance in all material respects will satisfy the requirements of such exemptions and that on Section 12(1) liability will attach where non-compliance is both innocent and immaterial.

Recommendation (6) The SEC should amend Rule 144 to allow the sale of securities thereunder by non-affiliates after a three year period without further regulatory requirements.

D. Uniform Federal-State Securities Regulation

Recommendation: The state securities administrators, through the North American Securities Administrators Association ("NASAA"), should develop and each state should adopt:

A. A uniform exemption at some level similar to Rule 504 of Regulation D; and

B. Uniform limited offering exemptions identical to Rule 505 and 506 of Regulation D.

E. Changes in Corporate Tax Rates and Brackets to Assist Small Business Capital Formation and Retention

Recommendation (1) Congress should modify the present corporate income tax rate and bracket structure. The highest corporate tax rate should apply to corporate taxable income of over $500,000 as contrasted with $100,000 at present. The lowest tax bracket should be increased substantially from its present $25,000 level, without increasing the 15 percent rate applicable after 1982. Other graduated tax brackets below $500,000 should be established.

Recommendation (2) Congress should give consideration to the following:

A. That small corporations be entitled to income average in the same manner individuals income average,

B. That the accumulated earnings tax exemption be raised from its present level of $250,000,

C. That dividends be deductible, to some extent, provided that they are reinvested in small business, and

D. That a small business data base be developed so that the significance of small business to the U.S. economy and the effect of proposed tax changes can be more accurately determined.

F. Changes In the Tax Treatment of Capital Gains to Provide a Stimulus to Capital Formation, Particularly for Smaller Businesses

Recommendation (1) Congress should amend the Internal Revenue Code to provide an investment tax credit, equal to 10 percent of funds invested, for investment in a "Qualified Small Business Investment" (QSBI).

1. Such credit would not be available for any investment if the source of such funds is the sale or other liquidation of a prior QSBI in a transaction occurring less than a specified number of years prior to the date of the new investment;

2. The capital gains tax otherwise payable with respect to any investment liquidations, upon election, shall be deferred on the portion of the capital funds which are reinvested in a QSBI within a certain period of time from the date of the transaction producing such capital gain. The tax may be deferred until a subsequent QSBI investment is liquidated, or until the date of liquidation of the last QSBI investment in a chair of transactions; and

3. A "Qualified Small Business Investment" would be:

(a) An equity security or debt instrument issued by a Small Business Investment Company, Business Development company, or a small business as determined by reference to the SBA small business size standards for SBIC investments;

(b) An equity security or debt instrument which does not permit the investor to require the repayment thereof sooner than five years after the date of the investment; provided that a debt instrument may provide for a minimum five year amortization; and

(c) In the case of a debt instrument, one which provides for interest not to exceed the then current federal financing bank rate.

Recommendation (2) Congress should amend the Internal Revenue Code to provide that after holding an equity or equity-type investment made directly in a small business for more than five years, the seller of such an investment would be entitled to exclude 80 percent of any gain realized on such investment.

Recommendation (3) Congress should amend the Internal Revenue Code to provide that any long-term capital gain realized upon the sale of an equity or equity-type investment made directly in a small business (as defined by the SBA) shall be taxed to a corporation at the maximum effective rate applicable to an individual for an identical investment.

Recommendation (4) Congress should amend the Internal Revenue Code to eliminate the ($50,000/100,000) limitation on loss deductions for Section 1244 small business stock. Corporations should be eligible for Section 1244 ordinary loss treatment. The stock limitation for Section 1244 corporations should be increased from $1 million to $5 million. Corporations and individuals should be allowed to take ordinary less deductions on all instruments (i.e., debt, perferred stock and guarantees, as well as common stock) used to invest in Section 1244 corporations.

Recommendations (5) Congress should pass legislation providing that the deductibility of interest paid on loans incurred to invest directly in small businesses (as defined by SBA) should be unlimited.

Recommendation (6) Congress should pass legislation providing that an individual investor with a substantial equity in a small business, who completely sells his shares in the business, may elect a one time exclusion of a percentage/dollar amount of any long-term capital gain realized thereby, if such investor has attained the age of 65, and has held his investment for 10 consecutive years preceding the sale.

## G. Additional Tax Modifications to Assist Small Business Capital Formation and Retention

Recommendation (1) (Section 385 Debt/Equity Regulation) Section 385 of the Internal Revenue Code should be repealed and existing law and guidelines should be used to distinguish debt and equity for tax purposes. However, should Congress, for policy reasons, determine that repeal is undesirable, the Treasury Department should be encouraged to adopt broad safe-harbors for small businesses under the Section 385 debt-equity regulations, which are easy to understand and apply, including:

1. An exemption from the regulations for corporations with less than $1 million in debt held by shareholders;
2. A shareholder debt to equity ratio safe-harbor of 5 to 1, replacing the 3 to 1 safe-harbor in previous versions of the regulations;
3. Exemption from regulations for corporations during the first five years of their existence;
4. Use of market value rather than book value of corporate assets for purposes of applying the safe-harbor, at the election of the corporation of instrument holder; and
5. Review of the application of the regulations to investments with conversion features.

Recommendation (2) (Subchapter S) Congress should (in addition to H.r. 6055) continue to study liberalization of Subchapter S, including the adoption of legislation:

1. Allowing more than one class of stock for Subchapter S corporations;
2. Allowing partnerships, corporations, and trusts to be shareholders of Subchapter S corporations;
3. Increasing the number of shareholders in a Subchapter S corporation to as many as 100;
4. Allowing Subchapter S corporations to form DISCs; and
5. Increasing the number of days during the taxable year for electing Subchapter S to as many as 240 days.

Recommendation (3) (Jobs Tax Credit) Congress should restore permanently the general jobs tax credit as originally enacted in the Tax Reduction and Simplification Act of 1977.

Recommendation (4) (Accounting Methods) Congress should amend the Internal Revenue Code to allow businesses with less than $3,000,000 in annual sales to elect for tax purposes either the cash receipts and disbursements method or the accrual method of accounting.

Recommendation (5) (Incentive Stock Option) Congress should revise the Incentive Stock Option provisions of Section 422A of the Internal Revenue Code including the following:

1. Increase the Section 422A(b) (8) ceiling limitation of $100,000 in order to permit appropriate equity opportunity necessary to attract key employees capable of contributing to the growth of an emerging company.

2. Eliminate the sequential exercise rule prescribed in Section 422A(b)(7).

3. Modify the Tax Equity Fiscal Responsibility Act of 1982 in order that the exercise of an Incentive Stock Option will not give rise to an item of tax preference under the alternative minimum tax provisions scheduled to go into effect December 30, 1982.

H. Federal Small Business Credit Assistance Programs

Recommendation (1) Congress should authorize SBA to permit revolving credit arrangements and other normal commercial loan accommodations in connection with small business loan guarantees.

Recommendation (2) Congress should raise SBA's loan guarantee limit to $1,000,000.

Recommendation (3) Congress should:

A. Increase the SBA loan guarantee authority; and

B. Expand the SBIC and 503 programs.

Recommendation (4) The SBA should:

A. Reduce extensive paper work and time delays, and simplify complex approval procedures which have characterized the loan guarantee program in the past.

B. Accelerate and expand to the extent possible the Certified Lenders Programs and non-bank lending programs.

Recommendation (5) The SBA should permit interest rates on guaranteed loans to be based on local primes or indices.

Recommendations (6) A survey of commercial banks and small businesses attitudes towards the SBA loan guarantee program should be conducted in order to remove impediments to increase utilization of the program.

Recommendation (7) The SBA should:

A. Support the SBA 503 program with sufficient SBA staff and debenture guarantee authority to meet loan demands of certified development companies;

B. Attempt to develop greater communication with its certified development companies and the National Association of Development Companies; and

C. Permit a ten-year debenture as well as 15-. 20-, and 25 year debentures.

Recommendation (8) The current tax exempt status of small business industrial revenue bonds (IRBs) should be be preserved and the sunsetting of IRB tax benefits is opposed. Policy should be changed to permit SBA and other agencies to participate with industrial revenue bonds in the same project. To enhance small business utilization of IRBs, the Internal Revenue Service should allow packaging of small IRB issues into one large issue.

Recommendation (9) Any legislation in connection with the financial industry should consider the needs of the small and medium sized banks which finance small business.

# APPENDIX G

## Public Law 97-35
## 97th Congress

## An Act

To provide for reconciliation pursuant to section 301 of the first concurrent resolution on the budget for the fiscal year 1982.

Aug. 13, 1981
[H.R. 3982]

### SHORT TITLE

SECTION 1. This Act may be cited as the "Omnibus Budget Reconciliation Act of 1981".

Omnibus Budget Reconciliation Act of 1981.

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### PURPOSE

SEC. 2. It is the purpose of this Act to implement the recommendations which were made by specified committees of the House of Representatives and the Senate pursuant to directions contained in part A of title III of the first concurrent resolution on the budget for the fiscal year 1982 (H. Con. Res. 115, 97th Congress), and pursuant to the reconciliation requirements which were imposed by such concurrent resolution as provided in section 310 of the Congressional Budget Act of 1974.

31 USC 1331.

# TITLE XIX—SMALL BUSINESS

Small Business Budget Reconciliation and Loan Consolidation/Improvement Act of 1981.
15 USC 631 note.
15 USC 636.

SEC. 1901. This title may be cited as the "Small Business Budget Reconciliation and Loan Consolidation/Improvement Act of 1981".

SEC. 1902. Subsection (a) of section 7 of the Small Business Act is amended to read as follows:

"(a) The Administration is empowered to the extent and in such amounts as provided in advance in appropriation Acts to make loans for plant acquisition, construction, conversion, or expansion, including the acquisition of land, material, supplies, equipment, and working capital, and to make loans to any qualified small business concern, including those owned by qualified Indian tribes, for purposes of this Act. Such financings may be made either directly or in cooperation with banks or other financial institutions through agreements to participate on an immediate or deferred (guaranteed) basis. These powers shall be subject, however, to the following restrictions, limitations, and provisions:

Loan authority limitations.

"(1) No financial assistance shall be extended pursuant to this subsection if the applicant can obtain credit elsewhere. No immediate participation may be purchased unless it is shown that a deferred participation is not available; and no direct financing may be made unless it is shown that a participation is not available.

"(2) In agreements to participate in loans on a deferred basis under this subsection, such participation by the Administration, except as provided in paragraph (6), shall be:

"(A) not less than 90 per centum of the balance of the financing outstanding at the time of disbursement if such financing does not exceed $100,000; and

"(B) subject to the limitation in paragraph (3)—

"(i) not less than 70 per centum nor more than 90 per centum of the financing outstanding at the time of disbursement if such financing exceeds $100,000 but is less than $714,285, and

"(ii) less than 70 per centum of the financing outstanding at the time of disbursement if such financing exceeds $714,285;

*Provided*, That the Administration shall not use the per centum of guarantee requested as a criterion to establish priorities in approving guarantee requests nor shall the Administration reduce the per centum guaranteed to less than 90 per centum pursuant to subparagraph (B) other than by a determination made on each application.

"(3) No loan under this subsection shall be made if the total amount outstanding and committed (by participation or otherwise) to the borrower from the business loan and investment fund established by this Act would exceed $500,000: *Provided*, That no such loan made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate basis shall exceed $350,000.

"(4) The rate of interest on financings made on a deferred basis shall be legal and reasonable but shall not exceed a rate prescribed by the Administration, and the rate of interest for the Administration's share of any direct or immediate participation loan shall not exceed the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of such loans and adjusted to the nearest one-eighth of 1 per centum, and an additional amount as determined by the Administration, but not to exceed 1 per centum per annum: *Provided*, That for those loans to assist any public or private organization for the handicapped or to assist any handicapped individual as provided in paragraph (10) of this subsection, the interest rate shall be 3 per centum per annum.

"(5) No such loans including renewals and extensions thereof may be made for a period or periods exceeding twenty-five years, except that such portion of a loan made for the purpose of acquiring real property or constructing, converting, or expanding facilities may have a maturity of twenty-five years plus such additional period as is estimated may be required to complete such construction, conversion, or expansion.

"(6) All loans made under this subsection shall be of such sound value or so secured as reasonably to assure repayment: *Provided, however*, That—

"(A) for loans to assist any public or private organization or to assist any handicapped individual as provided in paragraph (10) of this subsection any reasonable doubt shall be resolved in favor of the applicant;

"(B) recognizing that greater risk may be associated with loans for energy measures as provided in paragraph (12) of this subsection, factors in determining 'sound value' shall include, but not be limited to, quality of the product or service; technical qualifications of the applicant or his employees; sales projections; and the financial status of the business concern: *Provided further*, That such status need

**not be as sound as that required for general loans under this subsection; and**

**"(C) the Administration shall not decline to participate in a loan on a deferred basis under this subsection solely because such loan will be used to refinance all or any part of the existing indebtedness of a small business concern, unless the Administration determines that—**

**"(i) the holder of such existing indebtedness is in a position likely to sustain a loss if such refinancing is not provided, and**

**"(ii) if the Administration provides such refinancing through an agreement to participate on a deferred basis, it will be in a position likely to sustain part or all of any loss which would have otherwise been sustained by the holder of the original indebtedness: *Provided further,* That the Administration may decline to approve such refinancing if it determines that the loan will not benefit the small business concern.**

**On that portion of the loan used to refinance existing indebtedness held by a bank or other lending institution, the Administration shall limit the amount of deferred participation to 80 per centum of the amount of the loan at the time of disbursement: *Provided further,* That any authority conferred by this subparagraph on the Administration shall be exercised solely by the Administration and shall not be delegated to other than Administration personnel.**

**"(7) The Administration may defer payments on the principal of such loans for a grace period and use such other methods as it deems necessary and appropriate to assure the successful establishment and operation of such concern.**

**"(8)(A) Any loan made under the authority of this subsection by the Administration in cooperation with a bank or other lending institution through an agreement to participate on a deferred basis, may, upon the concurrence of the Administration, borrower and such bank or institution, have the term of such loan extended or such loan refinanced with an extension of its term: *Provided,* That the aggregate term of such extended or refinanced loan does not exceed the term permitted pursuant to paragraph (5): *And provided further,* That such extended loans, or refinancings shall be repaid in equal installments of principal and interest.**

**"(B) An additional service fee not exceeding 1 per centum of the outstanding amount of the principal may be paid by the borrower to the lender in consideration for such lender extending the term or refinancing of such borrower's indebtedness if such extension or refinancing results in the term of such indebtedness exceeding ten years.**

**"(C) The authority provided in this paragraph shall not be construed to otherwise limit the authority of the Administration to set terms and conditions of the loan.**

**"(9) The Administration may provide loans under this subsection to finance residential or commerical construction or rehabilitation for sale: *Provided, however,* That such loans shall not be used primarily for the acquisition of land.**

**"(10) The Administration may provide loans under this subsection to assist any public or private organization for the handicapped or to assist any handicapped individual in establishing, acquiring, or operating a small business concern.**

"(11) The Administration may provide loans under this subsection to any small business concern, or to any qualified person seeking to establish such a concern when it determines that such loan will further the policies established in section 2(c) of this Act, with particular emphasis on the preservation or establishment of small business concerns located in urban or rural areas with high proportions of unemployed or low-income individuals or owned by low-income individuals. 15 USC 631.

"(12) The Administration may provide loans under this subsection to assist any small business concern, including start up, to enable such concern to design architecturally or engineer, manufacture, distribute, market, install, or service energy measures: *Provided, however,* That such loan proceeds shall not be used primarily for research and development.

"(13) The Administration may provide financings under this subsection to State and local development companies for the purposes of, and subject to the restrictions in, title V of the Small Business Investment Act of 1958. 15 USC 695.

"(14) The Administration under this subsection may provide extensions and revolving lines of credit for export purposes to enable small business concerns to develop foreign markets and for preexport financing: *Provided, however,* That no such extension or revolving line of credit may be made for a period or periods exceeding eighteen months. A bank or participating lending institution may establish the rate of interest on extensions and revolving lines of credit as may be legal and reasonable.

"(15)(A) The Administration may guarantee loans under this subsection to qualified employee trusts with respect to a small business concern for the purpose of purchasing stock of the concern under a plan approved by the Administrator which, when carried out, results in the qualified employee trust owning at least 51 per centum of the stock of the concern.

"(B) The plan requiring the Administrator's approval under subparagraph (A) shall be submitted to the Administration by the trustee of such trust with its application for the guarantee. Such plan shall include an agreement with the Administrator which is binding on such trust and on the small business concern and which provides that—

"(i) not later than the date the loan guaranteed under subparagraph (A) is repaid (or as soon thereafter as is consistent with the requirements of section 401(a) of the Internal Revenue Code of 1954), at least 51 per centum of the total stock of such concern shall be allocated to the accounts of at least 51 per centum of the employees of such concern who are entitled to share in such allocation, 26 USC 401.

"(ii) there will be periodic reviews of the role in the management of such concern of employees to whose accounts stock is allocated, and

"(iii) there will be adequate management to assure management expertise and continuity.

"(C) In determining whether to guarantee any loan under this paragraph, the individual business experience or personal assets of employee-owners shall not be used as criteria, except inasmuch as certain employee-owners may assume managerial responsibilities, in which case business experience may be considered.

"(D) For purposes of this paragraph, a corporation which is controlled by any other person shall be treated as a small business concern if such corporation would, after the plan described in subparagraph (B) is carried out, be treated as a small business concern.

Report to Congress.

"(E) The Administration shall compile a separate list of applications for assistance under this paragraph, indicating which applications were accepted and which were denied, and shall report periodically to the Congress on the status of employee-owned firms assisted by the Administration.".

Definitions.
15 USC 632.

SEC. 1903. Section 3 of the Small Business Act is amended by adding thereto the following subsections:

15 USC 636.

25 USC 450b.

"(d) For purposes of section 7 of this Act, the term 'qualified Indian tribe' means an Indian tribe as defined in section 4(a) of the Indian Self-Determination and Education Assistance Act, which owns and controls 100 per centum of a small business concern.

"(e) For purposes of section 7 of this Act, the term 'public or private organization for the handicapped' means one—

"(1) which is organized under the laws of the United States or of any State, operated in the interest of handicapped individuals, the net income of which does not inure in whole or in part to the benefit of any shareholder or other individual;

"(2) which complies with any applicable occupational health and safety standard prescribed by the Secretary of Labor; and

"(3) which, in the production of commodities and in the provision of services during any fiscal year in which it received financial assistance under this subsection, employs handicapped individuals for not less than 75 per centum of the man-hours required for the production or provision of the commodities or services.

"(f) For purposes of section 7 of this Act, the term 'handicapped individual' means a person who has a physical, mental, or emotional impairment, defect, ailment, disease, or disability of a permanent nature which in any way limits the selection of any type of employment for which the person would otherwise be qualified or qualifiable.

"(g) For purposes of section 7 of this Act, the term 'energy measures' includes—

"(1) solar thermal energy equipment which is either of the active type based upon mechanically forced energy transfer or of the passive type based on convective, conductive, or radiant energy transfer or some combination of these types;

"(2) photovoltaic cells and related equipment;

"(3) a product or service the primary purpose of which is conservation of energy through devices or techniques which increase the energy efficiency of existing equipment, methods of operation, or systems which use fossil fuels, and which is on the Energy Conservation Measures list of the Secretary of Energy or which the Administrator determines to be consistent with the intent of this subsection;

"(4) equipment the primary purpose of which is production of energy from wood, biological waste, grain, or other biomass source of energy;

"(5) equipment the primary purpose of which is industrial cogeneration of energy, district heating, or production of energy from industrial waste;

"(6) hydroelectric power equipment;

"(7) wind energy conversion equipment; and

"(8) engineering, architectural, consulting, or other professional services which are necessary or appropriate to aid citizens in using any of the measures described in paragraph (1) through (7).

"(h) For purposes of this Act, the term 'credit elsewhere' means the availability of credit from non-Federal sources on reasonable terms and conditions taking into consideration the prevailing rates and terms in the community in or near where the concern transacts business, or the homeowner resides, for similar purposes and periods of time.

15 USC 636.

"(i) For purposes of section 7 of this Act, the term 'homeowners' includes owners and lessees of residential property and also includes personal property.".

Report to congressional committees.
15 USC 639.

SEC. 1904. Section 10(b) of the Small Business Act is amended by striking out "subsection" and all that follows and by inserting in lieu thereof, "this Act. Such report shall provide such information separately on each type of loan made under paragraphs (10) through (15) of section 7(a) and separately for all other loan programs. In addition, the information on loans shall be supplied on a monthly basis to the Committee on Small Business of the Senate and the Committee on Small Business of the House of Representatives.".

15 USC 631 note.

SEC. 1905. Section 20 of the Small Business Act is amended by striking out all after subsection (j) and inserting the following:

Loan program expenditure levels.

"(k) The following program levels are authorized for fiscal year 1982:

"(1) For the programs authorized by section 7(a) of this Act, the Administration is authorized to make $195,000,000 in direct and immediate participation loans; and of such sum, the Administration is authorized to make $15,000,000 in loans as provided in paragraph (10), $45,000,000 in loans as provided in paragraph (11), and $10,000,000 in loans as provided in paragraph (12).

15 USC 697.

"(2) For the programs authorized by 7(a) of this Act, and section 503 of the Small Business Investment Act of 1958, the Administration is authorized to make $3,140,000,000 in deferred participation loans and guarantees of debentures; and of such sum, the Administration is authorized to make $5,000,000 in loans as provided in paragraph (10), $60,000,000 in loans as provided in paragraph (11), $17,000,000 in loans as provided in paragraph (12), and $250,000,000 in loans as provided in paragraph (13) and guarantees of debentures as proivded in section 503.

15 USC 681.

"(3) For the programs authorized by title III of the Small Business Investment Act of 1958, the Administration is authorized to make $35,000,000 in direct purchase of debentures and preferred securities and to make $160,000,000 in guarantees of debentures.

15 USC 694a.

"(4) For the programs authorized by part B of title IV of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $1,400,000,000.

15 USC 636.

"(5) For the program authorized by section 7(b)(3) of this Act, the Administration shall not enter into any loans, guarantees, or other obligations or commitments.

15 USC 694-1, 694-2.

"(6) For the programs authorized in sections 404 and 405 of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $250,000,000.

"(7) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for the carrying out of the provisions and purposes, including administrative expenses, of sections 7(b)(1) and 7 (b)(2) of this Act; and there are authorized to be transferred from the disaster loan revolving funds such sums as may be necessary and appropriate for such administrative expenses.

"(l) There are authorized to be appropriated to the Administration for fiscal year 1982, $623,000,000. Of such sum, $362,000,000 shall be available for the purpose of carrying out the programs referred to in subsection (k), paragraphs (1) through (3); $30,000,000 shall be available for the purpose of carrying out the provisions of section 412 of the Small Business Investment Act of 1958; $4,000,000 shall be available for the purpose of carrying out the provisions of section 403 of the Small Business Investment Act of 1958; and $227,000,000 shall be available for salaries and expenses of the Administration of which amount—

Appropriation authorization.

15 USC 694c.

15 USC 694.

"(1) $12,526,000 shall be available for procurement and technical assistance; of which amount not less than $2,318,000 shall be available for technical assistance, and of this amount not less than $903,000 shall be used to pay for the continued development of a procurement automated source system, and not less than $175,000 shall be used to develop and maintain technology assistance centers which shall have direct or indirect access to a minimum of thirty technology data banks to define the technology problems or needs of small businesses by searching technology data banks or other sources to locate, obtain and interpret the appropriate technology for such small business.

"(2) $26,638,000 shall be available for management assistance of which amount not less than $1,214,000 shall be used to sustain the small business export development program and to employ not less than seventeen staff people for the Office of International Trade, ten of whom shall serve as export development specialists with each of the Administration's regional offices being assigned one such specialist.

"(3) $8,000,000 shall be available for economic research and analysis and advocacy, of which amount not less than $2,420,000 shall be used to employ at least sixty-nine staff people for the office of the Chief Counsel for Advocacy to carry out research and those functions prescribed by Public Law 94-305; not less than $1,400,000 shall be used to develop an external small business data bank and small business index; not less than $1,350,000 shall be used for research; and not less than $1,000,000 shall be used to pay for development and maintenance of an indicative small business data base comprised of names and addresses and related information.

15 USC 636 note.

"(4) $30,250,000 shall be available for the Office of Minority Small Business and Capital Ownership Development, $13,655,000 of which shall be used to carry out those functions, including administrative expenses, prescribed by section 7(j) of this Act.

15 USC 636.

"(5) $10,546,000 shall be available for program evaluation and data management with priority given to the development of an automated internal Administration management data base, to the enhancement of the Administration's document tracking system, and to the installation of terminals in Administration field offices.

"(6) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for carrying out the provisions and purposes of the small business development center program in section 21.

15 USC 631 note.

Funds, transfer.
15 USC 631 note.

"(m) The Administrator may transfer no more than 10 per centum of each of the total levels for salaries and expenses authorized in paragraphs (1) through (5) of section 20(l) of this Act: *Provided, however,* That no level authorized in such paragraphs may be increased more than 20 per centum by any such transfers.

Program expenditure levels.
15 USC 636.

"(n) The following program levels are authorized for fiscal year 1983:

"(1) For the programs authorized by section 7(a) of this Act, the Administration is authorized to make $195,000,000 in direct and immediate participation loans; and of such sum, the Administration is authorized to make $15,000,000 in loans as provided in paragraph (10), $45,000,000 in loans as provided in paragraph (11), and $10,000,000 in loans as provided in paragraph (12).

15 USC 697.

"(2) For the programs authorized by section 7(a) of this Act and section 503 of the Small Business Investment Act of 1958, the Administration is authorized to make $3,140,000,000 in deferred participation loans and guarantees of debentures; and of such sum, the Administration is authorized to make $5,000,000 in loans as provided in paragraph (10), $60,000,000 in loans as provided in paragraph (11), $17,000,000 in loans as provided in paragraph (12), and $350,000,000 in loans as provided in paragraph (13) and guarantees of debentures as provided in section 503.

15 USC 681.

"(3) For the programs authorized by title III of the Small Business Investment Act of 1958, the Administration is authorized to make $35,000,000 in direct purchases of debentures and preferred securities and to make $160,000,000 in guarantees of debentures.

15 USC 694a.

"(4) For the programs authorized by part B of title IV of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $1,400,000,000.

"(5) For the program authorized by section 7(b)(3) of this Act, the Administration shall not enter into any loans, guarantees, or other obligations or commitments.

15 USC 694-1, 694-2.

"(6) For the programs authorized in sections 404 and 405 of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $250,000,000.

"(7) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for the carrying out of the provisions and purposes, including administrative expenses, of sections 7(b)(1) and 7(b)(2) of this Act; and there are authorized to be transferred from the disaster loan revolving funds such sums as may be necessary and appropriate for such administrative expenses.

Appropriation authorization.

"(o) There are authorized to be appropriated to the Administration for fiscal year 1983, $675,000,000. Of such sum, $408,000,000 shall be available for the purpose of carrying out the programs referred to in subsection (n), paragraphs (1) through (3); $30,000,000 shall be available for the purpose of carrying out the provisions of section 412 of the Small Business Investment Act of 1958; $4,000,000 shall be available for the purpose of carrying out the provisions of section 403 of the Small Business Investment Act of 1958; and $233,000,000 shall be available for salaries and expenses of the Administration of which amount—

15 USC 694c.
15 USC 694.

"(1) $12,526,000 shall be available for procurement and technical assistance; of which amount not less than $2,318,000 shall be available for technical assistance, and of this amount not less than $903,000 shall be used to pay for the continued development of a procurement automated source system, and not less than $175,000 shall be used to develop and maintain technology assistance centers which shall have direct or indirect access to a minimum of thirty technology data banks to define the technology problems or needs of small businesses by searching technology data banks or other sources to locate, obtain and interpret the appropriate technology for such small business.

"(2) $29,638,000 shall be available for management assistance of which amount not less than $1,214,000 shall be used to sustain the small business export development program and to employ not less than seventeen staff people for the Office of International Trade, ten of whom shall serve as export development specialists with each of the Administration's regional offices being assigned one such specialist.

"(3) $8,000,000 shall be available for economic research and analysis and advocacy, of which amount not less than $2,420,000 shall be used to employ at least sixty-nine staff people for the office of the Chief Counsel for Advocacy to carry out research and those functions prescribed by Public Law 94-305; not less than $1,400,000 shall be used to develop an external small business data bank and small business index; not less than $1,350,000 shall be used for research; and not less than $1,000,000 shall be used to pay for development and maintenance of an indicative small business data base comprised of names and addresses and related information. 15 USC 636 note.

"(4) $30,250,000 shall be available for the Office of Minority Small Business and Capital Ownership Development, $13,655,000 of which shall be used to carry out those functions, including administrative expenses, prescribed by section 7(j) of this Act. 15 USC 636.

"(5) $10,546,000 shall be available for program evaluation and data management with priority given to the development of an automated internal Administration management data base, to the enhancement of the Administration's document tracking system, and to the installation of terminals in Administration field offices.

"(6) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for carrying out the provisions and purposes of the Small business development center program in section 21. 15 USC 631 note.

Funds, transfer.

"(p) The Administrator may transfer no more than 10 per centum of each of the total levels for salaries and expenses authorized in paragraphs (1) through (5) of section 20(o) of this Act: *Provided, however,* That no level authorized in such paragraphs may be increased more than 20 per centum by any such transfers. 15 USC 631 note.

Loan program expenditure levels.

"(q) The following program levels are authorized for fiscal year 1984:

"(1) For the programs authorized by section 7(a) of this Act, the Administration is authorized to make $195,000,000 in direct and immediate participation loans; and of such sum, the Administration is authorized to make $15,000,000 in loans as provided in paragraph (10), $45,000,000 in loans as provided in paragraph (11), and $10,000,000 in loans as provided in paragraph (12).

"(2) For the programs authorized by 7(a) of this Act and section 503 of the Small Business Investment Act of 1958, the Administration is authorized to make $3,140,000,000 in deferred participation loans and guarantees of debentures; and of such sum, the Administration is authorized to make $5,000,000 in loans as 15 USC 697.

provided in paragraph (10), $60,000,000 in loans as provided in paragraph (11), $17,000,000 in loans as provided in paragraph (12), and $350,000,000 in loans as provided in paragraph (13) and guarantees of debentures as provided in section 503.

15 USC 697.

"(3) For the programs authorized by title III of the Small Business Investment Act of 1958, the Administration is authorized to make $35,000,000 in direct purchases of debentures and preferred securities and to make $160,000,000 in guarantees of debentures.

15 USC 681.

"(4) For the programs authorized by part B of title IV of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $1,400,000,000.

15 USC 694a.

"(5) For the program authorized by section 7(b)(3) of this Act, the Administration shall not enter into any loans, guarantees, or other obligations or commitments.

15 USC 636.

"(6) For the programs authorized in sections 404 and 405 of the Small Business Investment Act of 1958, the Administration is authorized to enter into guarantees not to exceed $250,000,000.

15 USC 694-1, 694-2.

"(7) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for the carrying out of the provisions and purposes, including administrative expenses, of sections 7(b)(1) and 7(b)(2) of this Act; and there are authorized to be transferred from the disaster loan revolving funds such sums as may be necessary and appropriate for such administrative expenses.

Appropriation authorization.

"(r) There are authorized to be appropriated to the Administration for fiscal year 1984, $804,000,000. Of such sum, $531,000,000 shall be available for the purpose of carrying out the programs referred to in subsection (q), paragraphs (1) through (3); $30,000,000 shall be available for the purpose of carrying out the provisions of section 412 of the Small Business Investment Act of 1958; $4,000,000 shall be available for the purpose of carrying out the provisions of section 403 of the Small Business Investment Act of 1958; and $239,000,000 shall be available for salaries and expenses of the Administration of which amount—

15 USC 694c.

15 USC 694.

"(1) $12,526,000 shall be available for procurement and technical assistance; of which amount not less than $2,318,000 shall be available for technical assistance, and of this amount not less than $903,000 shall be used to pay for the continued development of a procurement automated source system, and not less than $175,000 shall be used to develop and maintain technology assistance centers which shall have direct or indirect access to a minimum of thirty technology data banks to define the technology problems or needs of small businesses by searching technology data banks or other sources to locate, obtain and interpret the appropriate technology for such small business.

"(2) $32,138,000 shall be available for management assistance of which amount not less than $1,214,000 shall be used to sustain the small business export development program and to employ not less than seventeen staff people for the Office of International Trade, ten of whom shall serve as export development specialists with each of the Administration's regional offices being assigned one such specialist.

"(3) $8,000,000 shall be available for economic research and analysis and advocacy, of which amount not less than $2,420,000 shall be used to employ at least sixty-nine staff people for the office of the Chief Counsel for Advocacy to carry out research and those functions prescribed by Public Law 94-305; not less than

15 USC 636 note.

$1,400,000 shall be used to develop an external small business data bank and small business index; not less than $1,350,000 shall be used for research; and not less than $1,000,000 shall be used to pay for development and maintenance of an indicative small business data base comprised of names and addresses and related information.

"(4) $30,250,000 shall be available for the Office of Minority Small Business and Capital Ownership Development, $13,655,000 of which shall be used to carry out those functions, including administrative expenses, prescribed by section 7(j) of this Act.

"(5) $10,546,000 shall be available for program evaluation and data management with priority given to the development of an automated internal Administration management data base, to the enhancement of the Administration's document tracking system, and to the installation of terminals in Administration field offices.

"(6) There are hereby authorized to be appropriated such sums as may be necessary and appropriate for carrying out the provisions and purposes of the small business development center program in section 21.

15 USC 631 note.

Funds, transfer.

"(s) The Administrator may transfer no more than 10 per centum of each of the total levels for salaries and expenses authorized in paragraphs (1) through (5) of section 20(r) of this Act: *Provided, however,* That no level authorized in such paragraphs may be increased more than 20 per centum by any such transfers.".

15 USC 631 note.

15 USC 631 note.

SEC. 1906. Section 20(h) of the Small Business Act is hereby amended by striking from paragraph (9) the figure "$110,000,000" and by inserting "$180,000,000".

Report to congressional committees.
15 USC 631 note.

SEC. 1907. Not later than February 28, 1984, and February 28, 1985, the Small Business Administration shall submit to the Committee on Small Business of the Senate and the Committee on Small Business of the House of Representatives, a report which shall contain—

15 USC 636.

(1) with respect to section 7(a)(5) of the Small Business Act—

(A) the aggregate number, dollar value, and default rate of all loans (other than for the acquisition of real property or for construction) having a maturity not in excess of ten years, and the aggregate number, dollar value, and default rate of all loans made for the purpose of acquiring real property or for construction having a maturity of between ten years and twenty years plus such additional period as is estimated may be required to complete such construction; and

(B) the aggregate number, dollar value, and default rate of all loans (other than for the acquisition of real property or for construction) made since the effective date of this section, having a maturity in excess of ten years, and the aggregate number, dollar value, and default rate of all loans made for the purpose of acquiring real property or for construction made since the effective date of this section, having a maturity in excess of twenty years plus such additional period as is estimated may be required to complete such construction;

(2) with respect to section 7(a)(8)(A) of the Small Business Act—

(A) the aggregate number, dollar value, and default rate of loans extended or refinanced pursuant to such section; and

(B) the average term of loans before such extension or refinancing and the average term of such loans after such extension or refinancing; and

15 USC 636.

(3) with respect to section 7(a)(6)(C) of the Small Business Act, the aggregate number, dollar value, and default rate of all loans refinanced pursuant to such provision.

15 USC 633.

Sec. 1908. Section 4(c)(1)(B) of the Small Business Act is amended by deleting "7(e), 7(h), 7(i), 7(l),".

15 USC 696.

Sec. 1909. Section 502 of the Small Business Investment Act of 1958 is amended by striking paragraphs (1) and (5) and by renumbering paragraphs (2), (3), and (4) as paragraphs (1), (2), and (3), respectively.

Sec. 1910. Sections 7(a)(6)(C) and 7(a)(8) of the Small Business Act as enacted herein are repealed October 1, 1985.

Disaster loans.

Sec. 1911. Sections 7(b)(1) and 7(b)(2) of the Small Business Act are amended to read as follows:

"(b) The Administration also is empowered to the extent and in such amounts as provided in advance in appropriation Acts—

"(1)(A) to make such loans (either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred (guaranteed) basis) as the Administration may determine to be necessary or appropriate to repair, rehabilitate or replace property, real or personal, damaged or destroyed by or as a result of floods, riots or civil disorders, or other catastrophes: *Provided*, That such damage or destruction is not compensated for by insurance or otherwise;

"(B) to refinance any mortgage or other lien against a totally destroyed or substantially damaged home or business concern: *Provided*, That no loan or guarantee shall be extended unless the Administration finds that (i) the applicant is not able to obtain credit elsewhere; (ii) such property is to be repaired, rehabilitated, or replaced; (iii) the amount refinanced shall not exceed the amount of physical loss sustained; and (iv) such amount shall be reduced to the extent such mortgage or lien is satisfied by insurance or otherwise;

"(2) to make such loans (either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred (guaranteed) basis) as the Administration may determine to be necessary or appropriate to any small business concern located in an area affected by a disaster, if the Administration determines that the concern has suffered a substantial economic injury as a result of such disaster and if such disaster constitutes—

"(A) a major disaster, as determined by the President under the Act entitled "An Act to authorize Federal assistance to States and local governments in major disasters, and for other purposes", approved September 30, 1950, as amended (42 U.S.C. 1855-1855g); or

"(B) a natural disaster, as determined by the Secretary of Agriculture pursuant to the Consolidated Farmers Home Administration Act of 1961 (7 U.S.C. 1961); or

"(C) a disaster, as determined by the Administrator of the Small Business Administration; or

"(D) if no disaster declaration has been issued pursuant to subparagraph (A), (B), or (C), the Governor of a State in which a disaster has occurred may certify to the Small Business Administration that small business concerns (1) have suffered economic injury as a result of such disaster, and (2) are in need of financial assistance which is not available on reasonable terms in the disaster stricken area. Upon receipt of such certification, the Administration may then make such loans as would have been available under this paragraph if a disaster declaration had been issued. *Provided,* That no loan or guarantee shall be extended pursuant to this paragraph (2) unless the Administration finds that the applicant is not able to obtain credit elsewhere.

Interest rates on Federal loans. 15 USC 636.

SEC. 1912. Section 7(c) of the Small Business Act is amended by adding the following:

"(4) Notwithstanding the provisions of any other law, the interest rate on the Federal share of any loan made under subsection (b) shall be—

"(A) in the case of a homeowner unable to secure credit elsewhere, the rate prescribed by the Administration but not more than one-half the rate determined by the Secretary of the Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of such loans plus an additional charge of not to exceed 1 per centum per annum as determined by the Administrator, and adjusted to the nearest one-eighth of 1 per centum but not to exceed 8 per centum per annum;

"(B) in the case of a homeowner able to secure credit elsewhere, the rate prescribed by the Administration but not more than the rate determined by the Secretary of the Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of such loans plus an additional charge of not to exceed 1 per centum per annum as determined by the Administrator, and adjusted to the nearest one-eighth of 1 per centum;

"(C) in the case of a business concern unable to obtain credit elsewhere, not to exceed 8 per centum per annum;

"(D) in the case of a business concern able to obtain credit elsewhere, the rate prescribed by the Administration but not in excess of the rate prevailing in private market for similar loans and not more than the rate prescribed by the Administration as the maximum interest rate for deferred participation (guaranteed) loans under section 7(a) of this Act. Loans under this subparagraph shall be limited to a maximum term of three years.

Such loans, subject to the reductions required by subparagraphs (A) and (B) of paragraph (1), shall be in amounts equal to 100 percent of loss if the applicant is a homeowner and 85 percent of loss if the applicant is a business or otherwise. The interest rates for loans made under paragraphs (1) and (2), as determined pursuant to this paragraph (4), shall be the rate of interest which is in effect on the date the disaster commenced: *Provided,* That no loan under paragraphs (1) and (2) shall be made, either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred (guaranteed) basis, if the total amount outstanding and committed to the borrower under this subsection would exceed $500,000 for each disaster unless an applicant constitutes a major source of employment in an area suffering a disaster, in which case the Administration, in its discretion, may waive the $500,000 limitation.".

Disaster loans.
*Ante*, p. 778.

SEC. 1913. (a) Section 7(b) of the Small Business Act is amended by striking out paragraphs (3) through (9) and inserting in lieu thereof the following:

"(3) to make such loans (either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis) as the Administration may determine to be necessary or appropriate to assist any small business concern in effecting additions to, alterations in, or reestablishment in the same or a new location of its plant, facilities, or methods of operation made necessary by direct action of the Federal Government or as a consequence of Federal Government action or to meet requirements or restrictions imposed on such concern under any Federal law heretofore or hereafter enacted or any State law enacted in conformity therewith, or any regulation or order of a duly authorized Federal, State, regional, or local agency issued in conformity with such Federal law, if the Administration determines that such concern is likely to suffer substantial economic injury or be unable to market a product without assistance under this paragraph: *Provided*, That the maximum loan made to any small business concern under this paragraph shall not exceed $500,000 and the amount thereof shall be based solely on a determination made on each application: *Provided further*, That no loan or guarantee shall be extended unless the Administration finds that the applicant is unable to obtain credit elsewhere.";

15 USC 633.

(b) Section 4(c)(1) of the Small Business Act is amended by striking all of subparagraph (A) after "7(b)(3)," and by inserting in lieu thereof "and 7(c)(2) of this Act; and".

(c) Section 7(g) of the Small Business Act is hereby repealed.

SEC. 1914. Section 7(c)(3) of the Small Business Act is amended by striking "to October 1, 1983" and by inserting "the effective date of this Act".

SEC. 1915. Section 4(c)(5)(B)(ii) of the Small Business Act is amended by striking all of the first sentence after "are made" and by inserting "from amounts appropriated for the disaster loan fund after October 1, 1980 or are made from repayments of principal of loans made from funds appropriated to the disaster loan fund, or from amounts appropriated to the business loan and investment fund on or after October 1, 1981 or are made from repayments of principal of loans made from funds appropriated to the business loan and investment fund and received on or after October 1, 1981.".

15 USC 636 note.

SEC. 1916. (a) Notwithstanding section 5(b)(6) of the Small Business Act, or any other provision of law, any business concern applicant for assistance made pursuant to paragraph (1), (2), or (4) of subsection 7(b) of the Small Business Act whose application was received but not approved by the Small Business Administration on or before March 19, 1981, shall be offered loan assistance by the Small Business Administration as provided in this section.

(b) The Small Business Administration is specifically directed to reconsider and act upon any such application and to make, remake, obligate, reobligate, commit or recommit such financing as provided herein.

(c) If the applicant was a business concern able to obtain credit elsewhere, the terms and conditions shall be those specified in section 7(b)(3) of the Small Business Act; but if the Administrator determines that imposition of these provisions would impose a substantial hardship on the applicant, he may, in his discretion on a case-by-case basis waive these provisions and provide assistance in accord with rules and regulations in effect for the date the disaster commenced for applicants able to secure credit elsewhere. If the applicant was a business concern unable to obtain credit elsewhere, or was an applicant under sections 7(b)(2) or 7(b)(4) of the Small Business Act, the terms and conditions shall be those in effect for such applicants on the date such application was first received. As used herein, the term "credit elsewhere" shall have the meaning prescribed by the Small Business Act as amended herein. 15 USC 636.

SEC. 1917. Section 231 of the Disaster Relief Act is hereby repealed. Repeal. 15 USC 636a.

SEC. 1918. Sections 1908, 1909, and 1913 of this title shall be effective October 1, 1981, and section 1910 of this title shall be effective as provided therein. All other provisions of this title shall be effective immediately but shall not affect any financing made, obligated, or committed under the Small Business Act or the Small Business Investment Act of 1958 prior to the effective date hereof. Effective dates. 15 USC 631 note. 15 USC 631 note, 661 note.

# APPENDIX H

Public Law 97-219
97th Congress

## An Act

**To amend the Small Business Act to strengthen the role of the small, innovative firms in federally funded research and development, and to utilize Federal research and development as a base for technological innovation to meet agency needs and to contribute to the growth and strength of the Nation's economy.**

July 22, 1982
[S. 881]

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

Small Business Innovation Development Act of 1982.
15 USC 631 note.
15 USC 638 note.

SECTION 1. This Act may be cited as the "Small Business Innovation Development Act of 1982".

SEC. 2. (a) The Congress finds that—

(1) technological innovation creates jobs, increases productivity, competition, and economic growth, and is a valuable counterforce to inflation and the United States balance-of-payments deficit;

(2) while small business is the principal source of significant innovations in the Nation, the vast majority of federally funded research and development is conducted by large businesses, universities, and Government laboratories; and

(3) small businesses are among the most cost-effective performers of research and development and are particularly capable of developing research and development results into new products.

(b) Therefore, the purposes of the Act are—

(1) to stimulate technological innovation;

(2) to use small business to meet Federal research and development needs;

(3) to foster and encourage participation by minority and disadvantaged persons in technological innovation; and

(4) to increase private sector commercialization innovations derived from Federal research and development.

15 USC 638.

SEC. 3. Section 9(b) of the Small Business Act is amended—

(1) by striking out "and" at the end of paragraph (2);

(2) by striking out the period at the end of paragraph (3) and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following:

"(4) to develop and maintain a source file and an information program to assure each qualified and interested small business concern the opportunity to participate in Federal agency small business innovation research programs;

"(5) to coordinate with participating agencies a schedule for release of SBIR solicitations, and to prepare a master release schedule so as to maximize small businesses' opportunities to respond to solicitations;

"(6) to independently survey and monitor the operation of SBIR programs within participating Federal agencies; and

Report to congressional committees.

"(7) to report not less than annually to the Committee on Small Business of the Senate and the Committee on Small Business of the House of Representatives on the SBIR programs of the Federal agencies and the Administration's information and monitoring efforts related to the SBIR programs.".

15 USC 638.

SEC. 4. Section 9 of the Small Business Act is amended by adding at the end thereof the following new subsections:

Definitions.

"(e) For the purpose of this section—

"(1) the term 'extramural budget' means the sum of the total obligations minus amounts obligated for such activities by employees of the agency in or through Government-owned, Government-operated facilities, except that for the Agency for International Development it shall not include amounts obligated solely for general institutional support of international research centers or for grants to foreign countries;

"(2) the term 'Federal agency' means an executive agency as defined in section 105 of title 5, United States Code, or a military department as defined in section 102 of such title, except that it does not include any agency within the Intelligence Community (as the term is defined in section 3.4(f) of Executive Order 12333 or its successor orders);

"(3) the term 'funding agreement' means any contract, grant, or cooperative agreement entered into between any Federal agency and any small business for the performance of experimental, developmental, or research work funded in whole or in part by the Federal Government;

"(4) the term 'Small Business Innovation Research Program' or 'SBIR' means a program under which a portion of a Federal agency's research or research and development effort is reserved for award to small business concerns through a uniform process having—

"(A) a first phase for determining, insofar as possible, the scientific and technical merit and feasibility of ideas submitted pursuant to SBIR program solicitations;

"(B) a second phase to further develop the proposed ideas to meet the particular program needs, the awarding of which shall take into consideration the scientific and technical merit and feasibility evidenced by the first phase and, where two or more proposals are evaluated as being of approximately equal scientific and technical merit and feasibility, special consideration shall be given to those proposals that have demonstrated third phase, non-Federal capital commitments; and

"(C) where appropriate, a third phase in which non-Federal capital pursues commercial applications of the research or research and development and which may also involve follow-on non-SBIR funded production contracts with a Federal agency for products or processes intended for use by the United States Government; and

"(5) the term 'research' or 'research and development' means any activity which is (A) a systematic, intensive study directed toward greater knowledge or understanding of the subject studied; (B) a systematic study directed specifically toward applying new knowledge to meet a recognized need; or (C) a systematic application of knowledge toward the production of useful materials, devices, and systems or methods, including design, development, and improvement of prototypes and new processes to meet specific requirements.

Research or research and development, budget.

"(f)(1) Each Federal agency which has an extramural budget for research or research and development in excess of $100,000,000 for fiscal year 1982, or any fiscal year thereafter, shall expend not less than 0.2 per centum of its extramural budget in fiscal year 1983 or in such subsequent fiscal year as the agency has such budget, not less than 0.6 per centum of such budget in the second fiscal year thereafter, not less than 1 per centum of such budget in the third fiscal year thereafter, and not less than 1.25 per centum of such budget in all subsequent fiscal years with small business concerns specifically in connection with a small business innovation research program which meets the requirements of the Small Business Innovation Development Act of 1982 and regulations issued thereunder: *Provided*, That any Federal agency which has an extramural budget for research or research and development in excess of $10,000,000,000 for fiscal year 1982 shall expend not less than 0.1 per centum of its extramural budget in fiscal year 1983, not less than 0.3 per centum of such budget in the second fiscal year thereafter, not less than 0.5 per centum of such budget in the third fiscal year thereafter, not less than 1 per centum of such budget in the fourth fiscal year thereafter, and not less than 1.25 per centum of such budget in all subsequent fiscal years with small business concerns specifically in connection with a small business innovation research program which meets the requirements of the Small Business Innovation Development Act of 1982 and regulations issued thereunder: *Provided further*, That a Federal agency shall not make available for the purpose of meeting the requirements of this subsection an amount of its extramural budget for basic research or research and development which exceeds the percentages specified herein. Funding agreements with small business concerns for research or research and development which result from competitive or single source selections other than under a small business innovation research program shall not be counted as meeting any portion of the percentage requirements of this subsection.

"(2) Amounts appropriated for atomic energy defense programs of the Department of Energy shall for the purposes of paragraph (1) be excluded from the amount of the research or research and development budget of that Department.

Small business innovation research program, requirements.

"(g) Each Federal agency required by subsection (f) to establish a small business innovation research program shall, in accordance with this Act and regulations issued hereunder—

"(1) unilaterally determine categories of projects to be in its SBIR program;

"(2) issue small business innovation research solicitations in accordance with a schedule determined cooperatively with the Small Business Administration;

"(3) unilaterally receive and evaluate proposals resulting from SBIR proposals;

"(4) unilaterally select awardees for its SBIR funding agreements;

"(5) administer its own SBIR funding agreements (or delegate such administration to another agency);

"(6) make payments to recipients of SBIR funding agreements on the basis of progress toward or completion of the funding agreement requirements; and

"(7) make an annual report on the SBIR program to the Small Business Administration and the Office of Science and Technology Policy.

"(h) In addition to the requirements of subsection (f), each Federal agency which has a budget for research or research and development in excess of $20,000,000 for any fiscal year beginning with fiscal year 1983 or subsequent fiscal year shall establish goals specifically for funding agreements for research or research and development to small business concerns, and no goal established under this subsection shall be less than the percentage of the agency's research or research and development budget expended under funding agreements with small business concerns in the immediately preceding fiscal year.

"(i) Each Federal agency required by this section to have an SBIR program or to establish goals shall report annually to the Small Business Administration the number of awards pursuant to grants, contracts, or cooperative agreements over $10,000 in amount and the dollar value of all such awards, identifying SBIR awards and comparing the number and amount of such awards with awards to other than small business concerns.

Policy directives.

"(j) The Small Business Administration, after consultation with the Administrator of the Office of Federal Procurement Policy, the Director of the Office of Science and Technology Policy, and the Intergovernmental Affairs Division of the Office of Management and Budget, shall, within one hundred and twenty days of the enactment of the Small Business Innovation Development Act of 1982, issue policy directives for the general conduct of the SBIR programs within the Federal Government, including providing for—

"(1) simplified, standardized, and timely SBIR solicitations;

"(2) a simplified, standardized funding process which provides for (A) the timely receipt and review of proposals; (B) outside peer review for at least phase two proposals, if appropriate; (C) protection of proprietary information provided in proposals; (D) selection of awardees; (E) retention of rights in data generated in the performance of the contract by the small business concern; (F) transfer of title to property provided by the agency to the small business concern if such a transfer would be more cost effective than recovery of the property by the agency; (G) cost sharing; and (H) cost principles and payment schedules;

"(3) exemptions from the regulations under paragraph (2) if national security or intelligence functions clearly would be jeopardized;

"(4) minimizing regulatory burden associated with participation in the SBIR program for the small business concern which will stimulate the cost-effective conduct of Federal research and development and the likelihood of commercialization of the results of research and development conducted under the SBIR program; and

"(5) simplified, standardized, and timely annual report on the SBIR program to the Small Business Administration and the Office of Science and Technology Policy.

"(k) The Director of the Office of Science and Technology Policy, in consultation with the Federal Coordinating Council for Science, Engineering and Research, shall, in addition to such other responsibilities imposed upon him by the Small Business Innovation Development Act of 1982—

"(1) independently survey and monitor all phases of the implementation and operation of SBIR programs within agencies required to establish an SBIR program, including compliance with the expenditures of funds according to the requirements of subsection (f) of this section; and

"(2) report not less than annually, and at such other times as the Director may deem appropriate, to the Committees on Small Business of the Senate and the House of Representatives on all phases of the implementation and operation of SBIR programs within agencies required to establish an SBIR program, together with such recommendations as the Director may deem appropriate.".

Report to congressional committees.

SEC. 5. Effective October 1, 1988, paragraphs (4) through (7) of section 9(b) of the Small Business Act (as added by section 3) and subsections (e) through (k) of section 9 of the Small Business Act (as added by section 4) are repealed.

15 USC 638.

SEC. 6. The Comptroller General shall, not more than five years after the date of enactment of this Act, transmit a report to the Senate and the House of Representatives on the implementation of, and nature of research conducted under this Act, including the judgments of the heads of Departments and agencies as to the effect of this Act on research programs.

Report to Congress.
15 USC 638 note.

Approved July 22, 1982.

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LEGISLATIVE HISTORY—S. 881 (H.R. 4326):

HOUSE REPORTS: No. 97-349, Pts. I-7 accompanying H. R. 4326 (Comms. on Small Business; Energy and Commerce; Veterans' Affairs; Science and Technology; Foreign Affairs; Armed Services; and Permanent Select Committee on Intelligence), respectively.
SENATE REPORT No. 97-194 (Comm. on Small Business).
CONGRESSIONAL RECORD:
  Vol. 127 (1981): Dec. 7, 8, considered and passed Senate.
  Vol. 128 (1982): June 17, 22, 23, H.R. 4326 considered and passed House; passage vacated and S. 881, amended, passed in lieu.
  June 29, Senate concurred in House amendment.
WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS:
  Vol. 18, No. 29 (1982): July 22, Presidential statement.

# APPENDIX I

Public Law 97-177
97th Congress

## An Act

To require the Federal Government to pay interest on overdue payments, and for other purposes.

May 21, 1982
[S. 1131]

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

Prompt Payment Act.

### SHORT TITLE

Section 1. This Act may be cited as the "Prompt Payment Act".

31 USC 1801 note.

### INTEREST PENALTIES ON LATE PAYMENTS

31 USC 1801.

Sec. 2. (a)(1) In accordance with regulations prescribed by the Director of the Office of Management and Budget, each Federal agency which acquires property or services from a business concern but which does not make payment for each such complete delivered item of property or service by the required payment date shall pay an interest penalty to such business concern in accordance with this section on the amount of the payment which is due.

(2) Such regulations—

(A) shall specify that the required payment date shall be—

(i) the date on which payment is due under the terms of the contract for the provision of such property or service; or

(ii) thirty days after receipt of a proper invoice for the amount of the payment due, if a specific date on which payment is due is not established by contract;

(B)(i) in the case of any acquisition of meat or of a meat food product, as defined in section 2(a)(3) of the Packers and Stockyards Act, 1921 (7 U.S.C. 182(3)), shall specify a required payment date which is not later than seven days after the date of delivery of such meat or meat food product; and

(ii) in the case of any acquisition of a perishable agricultural commodity, as defined in section 1(4) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499a(4)), shall specify a required payment date consistent with requirements imposed pursuant to such Act;

(C) shall specify separate required payment dates for contracts under which property or services are provided in a series of partial executions or deliveries, to the extent that such contract provides for separate payment for such partial execution or delivery; and

(D) shall require that, within fifteen days after the date on which any invoice is received, Federal agencies notify the business concern of any defect or impropriety in such invoice which would prevent the running of the time period specified in subparagraph (A)(ii).

(b)(1) Interest penalties on amounts due to a business concern under this Act shall be paid to the business concern for the period beginning on the day after the required payment date and ending on the date on which payment of the amount due is made, except that no interest penalty shall be paid if payment for the complete delivered item of property or service concerned is made on or before (A) the third day after the required payment date, in the case of meat or a meat food product described in subsection (a)(2)(B)(i); (B) the fifth day after the required payment date, in the case of an agricultural commodity described in subsection (a)(2)(B)(ii); or (C) the fifteenth day after the required payment date, in the case of any other item. Interest shall be computed at the rate determined by the Secretary of the Treasury for interest payments under section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611). The Secretary of the Treasury shall publish each such rate in the Federal Register.

Interest rate computation.

Publication in Federal Register.

Unpaid interest penalty.

(2) Any amount of an interest penalty which remains unpaid at the end of any thirty-day period shall be added to the principle amount of the debt and thereafter interest penalties shall accrue on such added amount.

(c) This section does not authorize the appropriation of additional funds for the payment of interest penalties required by this section. A Federal agency shall pay any interest penalties required by this section out of funds made available for the administration or operation of the program for which the penalty was incurred.

Interest penalty payments.

(d)(1) Any recipient of a grant from a Federal agency may provide in a contract for acquisition of property or services from a business concern for the payment of interest penalties on amounts overdue under such contract, except that—

(A) in no case shall an obligation to pay such interest penalties be construed to be an obligation of the United States, and

(B) any payment of such interest penalties shall not be made from funds provided to the grant recipient by a Federal agency, nor shall any non-Federal funds expended for such interest penalties be counted toward any matching requirement applicable to that grant.

(2) Such interest penalty payments shall be made under such terms and conditions as agreed to by the grant recipient and the business concern, consistent with the grant recipient's usual business practices and applicable State and local law.

### LIMITATION ON DISCOUNT PAYMENTS

31 USC 1802.

SEC. 3. (a) If a business concern offers a Federal agency a discount from the amount otherwise due under a contract for property or services in exchange for payment within a specified period of time, the Federal agency may make payment in an amount equal to the discounted price only if payment is made within such specified period of time.

(b) Each agency which violates subsection (a) shall pay an interest penalty on any amount which remains unpaid in violation of such subsection. Such interest penalty shall accrue on such unpaid amount in accordance with the regulations prescribed pursuant to section 2, except that the required payment date with respect to such unpaid amount shall be the last day of the specified period of time described in subsection (a).

### CLAIMS; RELATION TO OTHER LAW

31 USC 1803.

SEC. 4. (a)(1) Claims for interest penalties which a Federal agency has failed to pay in accordance with the requirements of section 2 or 3 of this Act may be filed under section 6 of the Contract Disputes Act of 1978 (41 U.S.C. 605).

(2) Interest penalties under this Act shall not continue to accrue (A) after the filing of a claim for such penalties under the Contract Disputes Act of 1978, or (B) for more than one year.

41 USC 601 note.

(3) Paragraph (2) shall not be construed to preclude the accrual of interest pursuant to section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611) after interest penalties have ceased accruing under this Act, and interest pursuant to such section may accrue on both any unpaid contract payment and on the unpaid interest penalty required by this Act.

(b) Except as provided in section 3 with respect to disputes concerning discounts, this Act shall not be construed to require interest penalties on payments which are not made by the required payment date by reason of a dispute between a Federal agency and a business concern over the amount of that payment or other allegations concerning compliance with a contract. Claims concerning any such dispute, and any interest which may be payable with respect to the period while the dispute is being resolved, shall be subject to the Contract Disputes Act of 1978.

### CONGRESSIONAL OVERSIGHT

Report, filing with OMB.
31 USC 1804.

SEC. 5. (a) Each Federal agency shall file with the Director of the Office of Management and Budget a detailed report on any interest penalty payments made under this Act during the preceding fiscal year.

Contents.

(b) Such report shall include the number, amounts, and frequency of interest penalty payments, and the reasons such payments were not avoided by prompt payment, and shall be delivered to the Director within sixty days after the conclusion of each fiscal year.

Federal agency compliance; submittal to congressional committees.

(c) The Director shall submit to the Committee on Governmental Affairs, the Committee on Appropriations, and the Committee on Small Business of the Senate and to the Committee on Government Operations, the Committee on Appropriations, and the Committee on Small Business of the House of Representatives within one hundred and twenty days after the conclusion of each fiscal year a report on Federal agency compliance with the requirements of this Act. Such report shall include a summary of the report submitted by each Federal agency under subsection (b) and an analysis of the progress made in reducing interest penalty payments by that agency from previous years.

### DEFINITIONS

31 USC 1805.

SEC. 6. For the purposes of this Act—

(1) the term "Federal agency" has the same meaning as the term "agency" in section 551(1) of title 5, United States Code, but also includes any entity (A) which is operated exclusively as an instrumentality of such an agency for the purpose of administering one or more programs of that agency, and (B)

which is so identified for this purpose by the head of such agency;

(2) the term "business concern" means any person engaged in a trade or business and nonprofit entities operating as contractors;

(3) an invoice shall be considered a "proper invoice" when it contains or is accompanied by such substantiating documentation (A) as the Director of the Office of Management and Budget may require by regulation, and (B) as the Federal agency involved may require by regulation or contract;

(4) an invoice shall be deemed to have been received by an agency on the later of—

(A) the date on which the agency's designated payment office or finance center actually receives a proper invoice; or

(B) the date on which such agency accepts the property or service concerned;

(5) a payment shall be considered made on the date on which a check for such payment is dated; and

(6) a contract for the rental of real or personal property is a contract for the acquisition of that property.

### EFFECTIVE DATE

31 USC 1801 note.

SEC. 7. (a) This Act applies to the acquisition of property or services on or after the beginning of the first calendar quarter which begins more than ninety days after the date of enactment of this Act.

31 USC 1801 note.

(b) The provisions of this Act requiring the promulgation of regulations shall be effective upon enactment, and such regulations shall be promulgated not later than ninety days after the date of enactment of this Act.

31 USC 1806.

(c) The provisions of this Act shall apply to the Tennessee Valley Authority, but any regulations promulgated under the authority of this Act shall not be applicable to the Tennessee Valley Authority, which shall be solely responsible for implementing the provisions of this Act with respect to its contracts.

Approved May 21, 1982.

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LEGISLATIVE HISTORY—S. 1131 (H.R. 4709):

HOUSE REPORT No. 97-461 accompanying H.R. 4709 (Comm. on Government Operations).
SENATE REPORT No. 97-302 (Comm. on Governmental Affairs).
CONGRESSIONAL RECORD:
Vol. 127 (1981): Dec. 15, considered and passed Senate.
Vol. 128 (1982): Mar. 23, H.R. 4709 considered and passed House; proceedings vacated and S. 1131, amended, passed in lieu.
May 11, Senate concurred in House amendments.

# APPENDIX J

## Public Law 97-247
## 97th Congress

## An Act

**To authorize appropriations to the Patent and Trademark Office in the Department of Commerce, and for other purposes.**

Aug. 27, 1982
[H.R. 6260]

Patent and Trademark Office. Appropriation authorization.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That there is authorized to be appropriated for the payment of salaries and necessary expenses of the Patent and Trademark Office to become available for fiscal year 1983, $76,000,000, and in fiscal years 1984 and 1985 such sums as may be necessary as well as such additional or supplemental amounts as may be necessary, for increases in salary, pay, retirement, or other employee benefits authorized by law. Funds available under this section shall be used to reduce by 50 per centum the payment of fees under section 41 (a) and (b) of title 35, United States Code, by independent inventors and nonprofit organizations as defined in regulations established by the Commissioner of Patents and Trademarks, and by small business concerns as defined in section 3 of the Small Business Act and by regulations established by the Small Business Administration. When so specified and to the extent provided in an appropriation Act, any amount appropriated pursuant to this section and, in addition, such fees as shall be collected pursuant to title 35, United States Code, and the Trademark Act of 1946, as amended (15 U.S.C. 1051 et seq.), may remain available without fiscal year limitation.

15 USC 632.

SEC. 2. Notwithstanding any other provision of law, there is authorized to be appropriated for the payment of salaries and expenses of the Patent and Trademark Office, $121,461,000 for the fiscal year ending September 30, 1982, and such additional or supplemental amounts as may be necessary for increases in salary, pay, retirement, or other employee benefits authorized by law.

SEC. 3. (a) Section 41(a) of title 35, United States Code, is amended to read as follows:

Fees.

"(a) The Commissioner shall charge the following fees:

"1. On filing each application for an original patent, except in design or plant cases, $300; in addition, on filing or on presentation at any other time, $30 for each claim in independent form which is in excess of three, $10 for each claim (whether independent or dependent) which is in excess of twenty, and $100 for each application containing a multiple dependent claim. For the purpose of computing fees, a multiple dependent claim as referred to in section 112 of this title or any claim depending therefrom shall be considered as separate dependent claims in accordance with the number of claims to which reference is made. Errors in payment of the additional fees may be rectified in accordance with regulations of the Commissioner.

35 USC 112.

"2. For issuing each original or reissue patent, except in design or plant cases, $500.

"3. In design and plant cases:

"a. On filing each design application, $125.

"b. On filing each plant application, $200.

"c. On issuing each design patent, $175.

"d. On issuing each plant patent, $250.

"4. On filing each application for the reissue of a patent, $300; in addition, on filing or on presentation at any other time, $30 for each claim in independent form which is in excess of the number of independent claims of the original patent, and $10 for each claim (whether independent or dependent) which is in excess of twenty and also in excess of the number of claims of the original patent. Errors in payment of the additional fees may be rectified in accordance with regulations of the Commissioner.

"5. On filing each disclaimer, $50.

"6. On filing an appeal from the examiner to the Board of Appeals, $115; in addition, on filing a brief in support of the appeal, $115, and on requesting an oral hearing before the Board of Appeals, $100.

"7. On filing each petition for the revival of an unintentionally abandoned application for a patent or for the unintentionally delayed payment of the fee for issuing each patent, $500, unless the petition is filed under sections 133 or 151 of this title, in which case the fee shall be $50.

35 USC 133, 151.

"8. For petitions for one-month extensions of time to take actions required by the Commissioner in an application:

"a. On filing a first petition, $50.

"b. On filing a second petition, $100.

"c. On filing a third or subsequent petition, $200.".

(b) Section 41(b) of title 35, United States Code, is amended to read as follows:

Maintenance fees.

"(b) The Commissioner shall charge the following fees for maintaining a patent in force:

"1. Three years and six months after grant, $400.

"2. Seven years and six months after grant, $800.

"3. Eleven years and six months after grant, $1,200.

Expiration.

Surcharge.

Unless payment of the applicable maintenance fee is received in the Patent and Trademark Office on or before the date the fee is due or within a grace period of six months thereafter, the patent will expire as of the end of such grace period. The Commissioner may require the payment of a surcharge as a condition of accepting within such six-month grace period the late payment of an applicable maintenance fee. No fee will be established for maintaining a design or plant patent in force.".

(c) Section 41(c) of title 35, United States Code, is amended to read as follows:

Maintenance fee, delayed payment.

Surcharge.

"(c)(1) The Commissioner may accept the payment of any maintenance fee required by subsection (b) of this section after the six-month grace period if the delay is shown to the satisfaction of the Commissioner to have been unavoidable. The Commissioner may require the payment of a surcharge as a condition of accepting payment of any maintenance fee after the six-month grace period. If the Commissioner accepts payment of a maintenance fee after the six-month grace period, the patent shall be considered as not having expired at the end of the grace period.

"(2) No patent, the term of which has been maintained as a result of the acceptance of a payment of a maintenance fee under this subsection, shall abridge or affect the right of any person or his successors in business who made, purchased or used after the six-month grace period but prior to the acceptance of a maintenance fee under this subsection anything protected by the patent, to continue the use of, or to sell to others to be used or sold, the specific thing so made, purchased, or used. The court before which such matter is in question may provide for the continued manufacture, use or sale of the thing made, purchased, or used as specified, or for the manufacture, use or sale of which substantial preparation was made after the six-month grace period but before the acceptance of a maintenance fee under this subsection, and it may also provide for the continued practice of any process, practiced, or for the practice of which substantial preparation was made, after the six-month grace period but prior to the acceptance of a maintenance fee under this subsection, to the extent and under such terms as the court deems equitable for the protection of investments made or business commenced after the six-month grace period but before the acceptance of a maintenance fee under the subsection.".

(d) Section 41(d) of title 35, United States Code, is amended to read as follows:

Fees.

"(d) The Commissioner will establish fees for all other processing, services, or materials related to patents not specified above to recover the estimated average cost to the Office of such processing, services, or materials. The yearly fee for providing a library specified in section 13 of this title with uncertified printed copies of the specifications and drawings for all patents issued in that year will be $50.".

35 USC 13.

Adjusted fees.

(e) Section 41(f) of title 35, United States Code, is amended to read as follows:

"(f) The fees established in subsections (a) and (b) of this section may be adjusted by the Commissioner on October 1, 1985, and every third year thereafter, to reflect any fluctuations occurring during the previous three years in the Consumer Price Index, as determined by the Secretary of Labor. Changes of less than 1 per centum may be ignored,".

(f) Subsection (a) of section 31 of the Trademark Act of 1946, as amended (15 U.S.C. 1113), is amended by deleting "Fees will be set and adjusted by the Commissioner to recover in aggregate 50 per centum of the estimated average cost to the Office of such processing. Fees for all other services or materials related to trademarks and other marks will recover the estimated average cost to the Office of performing the service or furnishing the material.".

(g) Section 42(c) of title 35, United States Code, is amended by adding the following sentence at the end thereof: "Fees available to the Commissioner under section 31 of the Trademark Act of 1946, as amended (15 U.S.C. 1113), shall be used exclusively for the processing of trademark registrations and for other services and materials related to trademarks.".

SEC. 4. Section 3(a) of title 35, United States Code is amended (1) by deleting the phrase "not more than fifteen"; and (2) by inserting the phrase "appointed under section 7 of this title" immediately after the phrase "examiners-in-chief".

SEC. 5. Section 111 of title 35, United States Code, is amended to read as follows:

Applications.

"SEC. 111. Application for patent shall be made, or authorized to be made, by the inventor, except as otherwise provided in this title, in writing to the Commissioner. Such application shall include (1) a specification as prescribed by section 112 of this title; (2) a drawing as prescribed by section 113 of this title; and (3) an oath by the applicant as prescribed by section 115 of this title. The application

35 USC 112.
35 USC 113.
35 USC 115.

must be accompanied by the fee required by law. The fee and oath may be submitted after the specification and any required drawing are submitted, within such period and under such conditions, including the payment of a surcharge, as may be prescribed by the Commissioner. Upon failure to submit the fee and oath within such prescribed period, the application shall be regarded as abandoned, unless it is shown to the satisfaction of the Commissioner that the delay in submitting the fee and oath was unavoidable. The filing date of an application shall be the date on which the specification and any required drawing are received in the Patent and Trademark Office.".

Filing date.

SEC. 6. (a) Section 116 of title 35, United States Code, is amended (1) by deleting the phrase "Joint inventors" from the title and inserting in its place "Inventors"; and (2) in the third paragraph, by deleting the phrase "a person is joined in an application for patent as joint inventor through error, or a joint inventor is not included in an application through error" and inserting in its place the phrase "through error a person is named in an application for patent as the inventor, or through error an inventor is not named in an application".

(b) Section 256 of title 35, United States Code, is amended to read as follows:

### "§ 256. Correction of named inventor

"Whenever through error a person is named in an issued patent as the inventor, or through error an inventor is not named in an issued patent and such error arose without any deceptive intention on his part, the Commissioner may, on application of all the parties and assignees, with proof of the facts and such other requirements as may be imposed, issue a certificate correcting such error.

"The error of omitting inventors or naming persons who are not inventors shall not invalidate the patent in which such error occurred if it can be corrected as provided in this section. The court before which such matter is called in question may order correction of the patent on notice and hearing of all parties concerned and the Commissioner shall issue a certificate accordingly.".

SEC. 7. Section 6 of title 35, United States Code, is amended by deleting paragraph (d) thereof.

SEC. 8. (a) Section 8(a) of the Trademark Act of 1946, as amended (15 U.S.C. 1058(a)), is amended (1) by deleting the word "still"; and (2) by inserting the phrase "in commerce" immediately after the word "use".

(b) Section 8(b) of the Trademark Act of 1946, as amended (15 U.S.C. 1058(b)), is amended (1) by deleting the word "still"; and (2) by inserting the phrase "in commerce" immediately after the word "use".

SEC. 9. (a) Section 13 of the Trademark Act of 1946, as amended (15 U.S.C. 1063), is amended (1) by deleting the phrase "a verified" and inserting in its place the word "an"; (2) by adding the phrase "when requested prior to the expiration of an extension" immediately after the word "cause"; and (3) by deleting the fourth sentence.

(b) Section 14 of the Trademark Act of 1946, as amended (15 U.S.C. 1064), is amended by deleting the word "verified".

SEC. 10. Section 15 of the Trademark Act of 1946, as amended (15 U.S.C. 1065), is amended by deleting the phrase "the publication" and inserting in its place the word "registration".

SEC. 11. The first sentence of section 16 of the Trademark Act of 1946, as amended (15 U.S.C. 1066), is amended to read as follows: "Upon petition showing extraordinary circumstances, the Commissioner may declare that an interference exists when application is made for the registration of a mark which so resembles a mark previously registered by another, or for the registration of which another has previously made application, as to be likely when applied to the goods or when used in connection with the services of the applicant to cause confusion or mistake or to deceive.".

SEC. 12. Section 21 of title 35, United States Code, is amended—

(1) by deleting the phrase "Day for taking action falling on Saturday, Sunday, or holiday" from the title and inserting in its place the phrase "Filing date and day for taking action";

(2) by inserting the following as subsection (a):

"(a) The Commissioner may by rule prescribe that any paper or fee required to be filed in the Patent and Trademark Office will be considered filed in the Office on the date on which it was deposited with the United States Postal Service or would have been deposited with the United States Postal Service but for postal service interruptions or emergencies designated by the Commissioner."; Filing date.

(3) by designating the existing paragraph as subsection (b); and

(4) by inserting the word "federal" in subsection (b), as designated above, immediately after the word "a".

SEC. 13. Section 6(a) of title 35, United States Code, is amended (1) by deleting the word "and", third occurrence, and inserting in its place a comma; (2) by inserting the phrase ", or exchanges of items or services" immediately after the word "programs"; and (3) by inserting the phrase "or the administration of the Patent and Trademark Office" immediately after the word "law", second occurrence.

SEC. 14. (a) Section 115 of title 35, United States Code, is amended by (1) deleting the phrase "shall be" and inserting in its place the word "is"; and (2) inserting the following immediately after the phrase "United States", third occurrence: ", or apostille of an official designated by a foreign country which, by treaty or convention, accords like effect to apostilles of designated officials in the United States".

(b) Section 261 of title 35, United States Code, is amended, in the third paragraph, by inserting the following immediately after the phrase "United States", third occurrence: ", or apostille of an official designated by a foreign country which, by treaty or convention, accords like effect to apostilles of designated officials in the United States".

(c) Section 11 of the Trademark Act of 1946, as amended (15 U.S.C. 1061), is amended by (1) deleting the phrase "shall be", first occurrence, and inserting in its place the word "is"; and (2) inserting the following immediately after the phrase "United States", third occurrence: ", or apostille of an official designated by a foreign country which, by treaty or convention, accords like effect to apostilles of designated officials in the United States".

SEC. 15. Section 13 of title 35, United States Code, is amended by deleting "(a) 9" and inserting in its place "(d)".

SEC. 16. Section 173 of title 35, United States Code, is amended to read as follows: "Patents for designs shall be granted for the term of fourteen years."

Effective dates.
35 USC 41 note.

SEC. 17. (a) Sections 1, 2, 4, 7, and 13 through 15 of this Act shall take effect on the date of enactment of this Act. Sections 3 and 16 of this Act shall take effect on October 1, 1982. The maintenance fees provided for in section 3(b) of this Act shall not apply to patents applied for prior to the date of enactment of this Act. Each patent applied for on or after the date of enactment of this Act shall be subject to the maintenance fees established pursuant to section 3(b) of this Act or to maintenance fees hereafter established by law, as to the amounts paid and the number and timing of the payments.

(b)(1) Title 35, United States Code, is amended by inserting after section 293 the following new section of chapter 29:

35 USC 294.

**"§ 294. Voluntary arbitration**

"(a) A contract involving a patent or any right under a patent may contain a provision requiring arbitration of any dispute relating to patent validity or infringement arising under the contract. In the absence of such a provision, the parties to an existing patent validity or infringement dispute may agree in writing to settle such dispute by arbitration. Any such provision or agreement shall be valid, irrevocable, and enforceable, except for any grounds that exist at law or in equity for revocation of a contract.

Awards.
9 USC 1 *et seq.*

35 USC 282.

"(b) Arbitration of such disputes, awards by arbitrators and confirmation of awards shall be governed by title 9, United States Code, to the extent such title is not inconsistent with this section. In any such arbitration proceeding, the defenses provided for under section 282 of this title shall be considered by the arbitrator if raised by any party to the proceeding.

Modification.

"(c) An award by an arbitrator shall be final and binding between the parties to the arbitration but shall have no force or effect on any other person. The parties to an arbitration may agree that in the event a patent which is the subject matter of an award is subsequently determined to be invalid or unenforceable in a judgment rendered by a court to competent jurisdiction from which no appeal can or has been taken, such award may be modified by any court of competent jurisdiction upon application by any party to the arbitration. Any such modification shall govern the rights and obligations between such parties from the date of such modification.

Notices.

Modification.

"(d) When an award is made by an arbitrator, the patentee, his assignee or licensee shall give notice thereof in writing to the Commissioner. There shall be a separate notice prepared for each patent involved in such proceeding. Such notice shall set forth the names and addresses of the parties, the name of the inventor, and the name of the patent owner, shall designate the number of the patent, and shall contain a copy of the award. If an award is modified by a court, the party requesting such modification shall give notice of such modification to the Commissioner. The Commissioner shall, upon receipt of either notice, enter the same in the record of the prosecution of such patent. If the required notice is not filed with the Commissioner, any party to the proceeding may provide such notice to the Commissioner.

"(e) The award shall be unenforceable until the notice required by subsection (d) is received by the Commissioner.".

(2) The analysis for chapter 29 of title 35 of the United States Code is amended by adding at the end the following:

"294. Voluntary arbitration.".

(c) Sections 5, 6, 8 through 12, and 17(b) of this Act shall take effect six months after enactment. 35 USC 294 note.

Approved August 27, 1982.

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LEGISLATIVE HISTORY—H.R. 6260:

HOUSE REPORT No. 97-542 (Comm. on the Judiciary).
CONGRESSIONAL RECORD, Vol. 128 (1982):
    June 8, considered and passed House.
    Aug. 12, considered and passed Senate.
WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 18, No. 36 (1982):
    Aug. 28, Presidential statement.